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THE ROYAL COMMISSION ON TAXATION

Hearing held in the Centre Court Room, Exchequer Court of Canada, Supreme Court Building, Wellington Street, Ottawa, Ontario, on Thursday, the 5th day of December, 1963.

C O M M I S S I O N

MR. KENNETH LeM.CARTER — CHAIRMAN

MR. J. HARVEY PERRY

MR. A. EMILE BEAUVAIS

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SECRETARY

MR. G. L. BENNETT

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---Upon commencing at 9:30 A.M.

THE CHAIRMAN: Mr. Secretary, we have reached the time and I think we will start.

THE SECRETARY: Good morning Mr. Chairman and Commissioners. This morning the brief is being presented by the Independent Petroleum Association of Canada. Mr. D. E. Mitchell, President of the Association is here together with a number of his colleagues. Mr. Mitchell is going to make a few introductory remarks and introduce his colleagues to the Commission.

This submission is in two parts, a supplement of the original brief together with a supplementary brief which I will enter into the record as one exhibit, Exhibit No. 279.

---EXHIBIT NO. 279: Original brief and supplement of the Independent Petroleum Association of Canada.

SUBMISSION OF

INDEPENDENT PETROLEUM ASSOCIATION OF CANADA

Appearances:
MR. D. E. MITCHELL, President Taxation Committee.
MR. R. F. BUCHANAN, Chairman, Taxation Committee.
MR. A. LARSEN, Director and Secretary of I.P.A.C.
MR. H. N. HOTCHKISS, Director of I.P.A.C.
MR. S. D. ALLEN, Foster Associates.
MR. H. G. PEARCE, Foster Associates.

THE CHAIRMAN: Thank you, Mr. Secretary. Good morning Mr. Buchanan and gentlemen.

Mr. Mitchell, you are the President of the Association?

MR. MITCHELL: Yes.

THE CHAIRMAN: We are glad to see you. You gave us some very interesting information to read, which we have enjoyed and we will have a few questions to put to you.

This morning we have asked our legal advisor and counsel to lead the questions. That does not mean we will not do a bit of questioning ourselves. It may take all morning to get through this and perhaps this afternoon too.

Before we proceed to our questions would you care to tell us a little bit about yourselves and your organization and if you have any introductory remarks to add to what is already here we would be glad to have them.

MR. MITCHELL: First, Mr. Chairman, I will introduce my colleagues at the table. My name is D. E. Mitchell and I am from Calgary, Vice-President of an oil firm there and President of the International Petroleum Association of Canada. Second from my right is Mr. Pearce of Foster Associates, the consulting firm retained by International Petroleum Association of Canada, who prepared this brief. On the right of Mr. Pearce is Mr. Allen, also of Foster Associates. On my immediate right is Mr. Buchanan, who is Chairman of the Taxation Committee for the Independent Petroleum Association of Canada. On my immediate left is Mr. Larsen, the Secretary and Director of the Association. On his left is Mr. Hotchkiss, a Director of the Association.

These are the gentlemen here to-day to answer

the questions brought forth by the Commission.

Mr. Chairman, I will read a brief opening statement. The Independent Petroleum Association of Canada is pleased to have this opportunity to appear before the Royal Commission on Taxation. The Canadian Petroleum Industry has contributed substantially to Canadian economic progress and we believe the independent producer has played a vital role in this contribution.

We define a Canadian independent producer as one which is wholly or very substantially dependent for its revenues and future growth upon oil and gas reserves in Canada. The role of the independent has been covered in the brief.

On the North American Continent the Canadian oil industry is relatively new as an important producer, dating from the discovery of Leduc in 1947. The industry grew rapidly and quickly reached the stage of direct price competition with older, established United States producers. This price competition became even keener when our expanded production surmounted a tariff barrier and moved into foreign markets.

In order to maintain our present markets or to reach into new markets, we must be competitive price-wise. This requires us to look at the depletion factor as part of our long-run economics.

Tax, in the final sense, is a cost factor which must be recovered in the selling price in determining a rate of return. Effective percentage depletion was a well-ingrained reduction in expense factor for the U.S. producer supplying the same markets when Canadian crude

oil first made entry.

As a result the Canadian industry is subject to higher income tax, transportation costs, and sales taxes are also higher. These have been major factors in decreasing the ability of Canadian independents to acquire funds for growth purposes.

The lack of ability to acquire sufficient funds for growth has undoubtedly been a large factor in the sell-out of many Canadian independents. At the present time investor interest in Canadian oil companies is relatively low and very little new equity money is available to these companies. As a result they largely must rely on internal cash flows and borrowed funds to the extent such are available. Borrowed funds should not replace risk capital for exploration.

In the past Canadian companies have been able to supplement their own available exploration funds with funds from U.S. investors, very often individuals or non oil companies, who are able to deduct their drilling cost against income from any source. This has been an important factor in the existence and growth of many of these companies.

Since the revision of the Canadian Oil and Gas Law in 1962, this U.S. source of funds has declined substantially. It is desirable that these U.S. funds be available and it is more important to the national interest that similar funds from Canadian sources be employed in the oil industry. This would not only provide new funds for the use of the Canadian independents, but would create added Canadian ownership of natural resources.

From studies included in the brief it is indicated that the industry in Canada does not earn a high rate of return. It is true that the very nature of exploration lends itself to an occasional important discovery early in an exploration programme but this, of course, is offset by the experience of others whose fortunes have not been as good and who may spend large sums of money without achieving any important results. In considering even a fortunate discovery we would still find that under present Canadian tax laws immediate deduction of drilling credits would result only in a temporary deferral of tax and that eventual realization of profits can come only in the form of taxable income, since the sale by the capital gain route is now closed.

It is true that the widening of the base of thos entitled to deduct drilling cost from other revenue would in a minor sense reduce immediate income tax revenue. In the longer run it would increase the taxation base.

The Canadian oil industry to-day seems to be in an inconsistent position where our markets are insufficient but an increase in the level of exploration is needed. Although we have excessive producing capacity to-day, our trend in years of future supply is downward. If this trend is continued we will eventually reach the point of insufficient current supply. The process of initial exploration through final drilling and production is a period of several years and substantial lead time is necessary to reverse the present trend.

This leads to the conclusion that there needs

to be additional financial incentive at an early date if exploration in the future is to be at a level which will provide sufficient supplies for a future time.

Tax incentives can take many forms, such as direct subsidies, tariff protection, or deductions which delay or lessen tax. The Canadian oil industry is not protected by a tariff, even though its exports are subject to a tariff when entering foreign markets. Nor is it receiving a subsidy as are some industries.

It is requesting incentives in the form of effective percentage depletion and a provision for broader Canadian participation in the industry. In the long run this should result in higher tax revenue to the Canadian Government, since the larger activities would in themselves create more employees who pay taxes, enlarge or create secondary industries which sell to and service the oil companies, and would produce additional sales tax revenues to the Government.

Ultimately it would produce a larger industry with a more Canadian content, which would be more effective in creating or saving foreign exchange. It seems inevitable that the ultimate tax revenue would also be increased.

In summary we urge first that there be equal opportunity created through the measures we have recommended for Canadians to participate in oil industry investment and ownership, and that there be early action to obtain this objective recognition of the substantial time that is necessary in the industry between investment and realization of increases in reserve and

productivity.

Thank you, Mr. Chairman.

THE CHAIRMAN: Thank you indeed. Mr. Stewart, are you ready to start questioning? I wish you would make it clear to us from your questions at the outset exactly the situation between an independent and integrated oil company. I would like to be sure I understand just who the independents are. I suppose some of them are regular dividend payers and some are most highly respectable concerns. I would like to know as much about that as possible, Mr. Stewart.

MR. STEWART: Yes, Mr.Chairman. I think we might start in this way: it is possible Mr. Mitchell could make available to us a copy of what he has just read. There were some thoughtful remarks amplifying some of the points made in the material before us and we might consider that statement further. Would you have an extra copy?

MR. MITCHELL: There is no extra copy inasmuch as the editing was done at a late hour. Perhaps I might confer with the Secretary in order to obtain that objective.

MR. STEWART: If you could make that available to the Secretary he could have a copy struck off and probably we could secure that by lunch time.

MR. MITCHELL: Thank you. We would be very pleased to co-operate.

MR. STEWART: Mr. Mitchell, going on with the basic question which the Chairman has raised, I am wondering if a simpler course might be to identify

the integrated companies, if we have a distinction between independents on one hand and major and integrated on the other. Would you deal with this and indicate what the distinction is and how many people come within each class?

MR. MITCHELL: Yes, sir. First I might say that defining and independent oil producer is a challenge for any of us at any time. There is an overlap that is implied in the question.

We define an independent producer by exclusion, you might say. We say that an independent producer is one which is wholly or substantially dependent upon Canadian sources of income and this is really the group that is before you to-day.

Now there are a few independent companies that are integrated and in that sense we can use the terms interchangeably. These are not very substantial in the overall marketing position of Canada but certainly they have a position.

The contrast perhaps in this definition is, you might say, the international oil company which has choice in its revenue and a choice as to whether it will sell a barrel of oil in a foreign country or a barrel of oil in Canada. Either way the funds come into the treasury.

This, sir, is perhaps in plain words as close as I can reasonably come to making that definition. I would be glad to further elaborate if you wish.

THE CHAIRMAN: Might I remark, Mr. Stewart, that I took the definition from Page II - 3 in the bound

submission where it says "Both the independent companies and integrated companies". I underlined the words because I thought that denoted a distinction. I see, as you have told me, that some of the independent companies are in fact integrated. Canadian Oils would have to come within the independent and also integrated class?

MR. MITCHELL: That is correct. The integrated companies within the independent group are so small in number we have tended to use the words in the brief "independent" on the one hand and "integrated" on the other. "Integrated" to indicate those companies which have other sources of revenue.

THE CHAIRMAN: There are so few do you mind mentioning who they are?

MR. MITCHELL: I think the most noteable example would be Husky.

THE CHAIRMAN: It has got service stations?

MR. MITCHELL: Yes, it has.

MR. STEWART: Would you put Supertest in that category?

MR. MITCHELL: Supertest is another.

MR. STEWART: Then, Mr. Mitchell, I take it there are American companies in the United States which might be regarded as independent but which also operate in Canada. If you consider your definition of "international" as one which may be selling in Canada and elsewhere some of these would be international in that sense or are you contemplating those selling outside of North America as within North America?

MR. MITCHELL: We really consider those

primarily outside of North America. There is indeed an inter-twining of this definition. We recognize it, Mr. Stewart. There seems to be no better way to arrive at a definition.

MR. STEWART: You would have integrated companies within your association.

MR. MITCHELL: Yes, we do. Canadian Husky is an example. Supertest is a member of the association.

MR. STEWART: Large Internationals such as Jersey Standard and Texaco and Royal Dutch and so on, they would not be members.

MR. MITCHELL: They are not members of the Association, that is correct.

MR. STEWART: Does that clear that up, Mr. Chairman?

THE CHAIRMAN: I think it does.

MR. MITCHELL: This includes too a subsidiary of the International Firm, such as Imperial Oil, for example. Imperial is not a member of the independent association.

MR. STEWART: And the Canadian affiliates of the majors, would they be members of your Association?

MR. MITCHELL: There may be one or two exceptions to that. The membership of the Association is really Canadian producers. There is one example now of a company that has been purchased by a larger company that is still on our rolls. We find this happening from time to time and treat each case in its own circumstances. Certainly excluded from the list would be a company such as Imperial which is established as a

subsidiary of International Oil Company.

THE CHAIRMAN: Then it really relates to ownership; does it not?

MR. MITCHELL: Yes, it is ownership coupled with dependence upon Canadian income.

COMMISSIONER PERRY: Has anyone ever tried to set all this out in your by-laws?

MR. MITCHELL: Each time there is a change in the Board of Directors of the Independent Association someone raises this point and it usually results in the suggestion that they be the head of a Committee. The solution is not forthcoming.

Strangely enough although we have this indefinite form of definition there is certainly a clear understanding among those in the Association as to what we are trying to do and as to whom will be able to try to do it on behalf of the Association.

We are an Association that looks to Canadian interests, Canadian production.

THE CHAIRMAN: Many of your members would be regular producers and be paying dividends? Or was that your next question, Mr. Stewart?

COMMISSIONER PERRY: I just had one further question as to the relationship of this Association to the Canadian Petroleum Association. You would be members?

MR. MITCHELL: Yes, we are members.

COMMISSIONER PERRY: You are not a protest group but a separate organization?

MR. MITCHELL: We come back to the dependence upon Canadian income again. The Canadian Petroleum

Association is, you might say, a sister or brother association to which most of us belong and we do so because it has substantial resources, you might say, in terms of personnel and otherwise to do jobs, for which we are all in agreement.

The Independent Association was really formed at a time when the oil industry in Canada was suffering very badly from lack of markets and there seemed to be no way of the two groups within the Associations getting together.

One group felt very strongly there should be a national oil policy and the other, I would interpret, felt there should be no united industry action to try and get this accomplished.

We of the independents come back to the same point, our reliance largely upon Canadian income and we have to do something to get the Canadian income provided, as we are attempting to do again to-day.

MR. STEWART: Your Association was formed when, Mr. Mitchell?

MR. MITCHELL: This association was formed in 1961. The Secretary will check that date.

MR. STEWART: Coming back to the Chairman's other point, when we consider to what extent the independents have been in a position to pay and have paid dividends could we look at them as a group or should we distinguish between independents which are subsidiaries or affiliates of foreign companies, on the one hand, and independents which are controlled in Canada, on the other hand.

MR. MITCHELL: I refer that to Mr. Larsen, if I may. The question was raised as to whether in considering the dividend paying companies they might be considered as a group.

MR. LARSEN: To the best of my recollection in looking at the list there might be approximately six oil companies that have a record of some common share dividend. None of them, I would say, are very substantial proportions. Basically it is a non-dividend paying group.

THE CHAIRMAN: That is six of your members?

MR. LARSEN: Six is the approximate number.

THE CHAIRMAN: Those are not subsidiaries of U.S. or other foreign companies?

MR. LARSEN: Basically not.

MR. STEWART: Those six presumably if they are on a dividend-paying basis will have been paying taxes on income and will have been taking depletion allowances?

MR. LARSEN: We are not fully aware of all those facts.

MR. STEWART: How many members of your Association would there be at the present time?

MR. LARSEN: The last count was I believe 137.

MR. STEWART: Of that 137 could you indicate particularly what percentage would be actual producers?

MR. LARSEN: Probably about two-thirds.

MR. STEWART: I take it that there would be a good many other independent companies which are engaged in exploration at any rate, and possibly in production, which do not happen to be members of your Association?

MR. LARSEN: Which are not members?

MR. STEWART: Yes.

MR. LARSEN: There are some others, but most of them are members of our Association.

MR. STEWART: That is most of the producers?

MR. LARSEN: Producers in any important sense.

COMMISSIONER PERRY: There is a footnote which gives the names of companies that have presented a brief in the name of somebody, Royal Commission on Energy. On Page 43. Could we take it these are the larger companies in the Association?

MR. MITCHELL: No, sir, not necessarily.

THE CHAIRMAN: We can take it these are members

of your Association, can we?

MR. MITCHELL: They were at the time of this record. One is no longer a member, sir. No, two of them are no longer members.

MR. STEWART: Is that because they have been taken over by some other company?

MR. MITCHELL: Yes, it is.

MR. STEWART: Well now, gentlemen, I would like to move on from here to discuss the position under Section 83 A of the Income Tax Act. So far as your industry is concerned, and so far as your members are concerned, and these questions, therefore, will relate to a considerable extent to the small submission which you have made, or the shorter submission. That sorther submission raises a number of questions about Section 83A, some of which are quite technical.

Before I get into them, which I would like to do, I would like to ask some more general questions, and the early ones at any rate I think, or at least I hope, are non-controversial.

I would like to be sure that we are on common ground in our approach to this particular section. I think the simplest thing would be for me to put a number of propositions to you and get your reaction to them. Would you agree that under the present provisions of the Section your members can deduct in the computation of income all their exploration and drilling expense, at least as far as the period after April 10, 1962 is concerned?

MR. BUCHANAN: Yes. I think that is a fair

question. We could certainly deduct those costs to the extent we have available income.

MR. STEWART: Now, since April 10, 1962, those exploration and drilling expenses that you can deduct have included certain land acquisition costs.

MR. BUCHANAN: That is right, Mr. Stewart, in connection with your Section as it pertains to your mineral rights any costs that have been incurred since the April date may be written off.

MR. STEWART: I take it that one major item which you still cannot deduct under Section 83A consists of the costs of rights acquired prior to April 10, 1962?

MR. BUCHANAN: That is right. The legislation in existence at that time, of course, placed certain limitations on the timing of the write-offs, and also qualified the basis on which they could be written off. As far as the future is concerned, of course, only if those lands are surrendered can we continue to get that write-off. If, for example, they were sold, then it would automatically mean that those costs would not be available as a write-off even though income received, gross income received from it, is now being treated as taxable income in our hands.

MR. STEWART: Thinking solely of these pre-April 10, 1962 acquisition costs, have you any idea what the total amount involved is so far as the industry is concerned? I am thinking of lands which have not been and which may not be possible to absorb through section 83A.

MR. BUCHANAN: I do not believe we could give

you a correct answer on that, Mr. Stewart. If we go back far enough, of course, we must recognize many of these costs were never allowed at all until legislation came into effect in 1956, and to my knowledge we did not have that information which would really give us a total figure on what you are talking about here.

I have heard, but I cannot substantiate the figures, probably about seven hundred and fifty million dollars.

MR. STEWART: I think in the pamphlet which was published recently by the Canadian Tax Foundation entitled "Oil and Gas Production and Taxes" -- this is one which, as you know, was published earlier this year -- I think there were two estimates; one of about five hundred million dollars and one of nine hundred million dollars, and your figure of seven hundred and fifty million dollars would be more or less in the middle of that range.

Well now, another type of expenditure which I take it cannot be recovered under Section 83A ( ) is expenditure on depreciable assets, that type of expenditure being recoverable through capital cost allowance.

MR. BUCHANAN: You are dealing strictly with equipment involved here, of course. It is divorced completely from your Section 83 A. .

MR. STEWART: Yes. Are there any other major items either pre-April 10, 1962 or subsequent to that date which cannot be recovered under Section 83 A?

MR. BUCHANAN: I have mentioned these prior land costs, of course, or mineral right costs.

MR. STEWART: Yes.

MR. BUCHANAN: I do not believe there is anything else, Mr. Stewart.

MR. STEWART: Well now, I have several other propositions which I think are correct, but if they are not, I would like you to tell me. This Section 83A deduction can and must be taken to the extent there is income immediately the income becomes available?

MR. BUCHANAN: Right.

MR. STEWART: It can be taken so far as companies whose principle business is in the petroleum field -- it can be taken from income from all sources?

MR. BUCHANAN: That is right, sir.

MR. STEWART: It can be carried forward indefinitely?

MR. BUCHANAN: Right.

MR. STEWART: And there is no tax therefore on production income until these costs have been completely absorbed?

MR. BUCHANAN: That is correct.

MR. STEWART: Now, I would like to make sure that we understand each other as to the distinction between the Canadian treatment of items of this nature and that in the United States. I have two propositions to put to you. The first is in the United States expense of this sort which relates to producing properties must be capitalized?

MR. LARSEN: I would say under the U.S. tax law rights to use the land in whatever form -- it may be leased -- can be written off when abandoned.

THE CHAIRMAN: Can be written off?

MR. LARSEN: When abandoned.

MR. STEWART: My question related to producing companies.

MR. LARSEN: To the extent that land adheres to producing property it can be written off to the greater of cost or percentage depletion.

MR. STEWART: I am trying to compare the treatment of exploration and drilling expense, including land acquisition costs, in the two countries before we get to the depletion stage. In Canada under Section 83 A, at the moment we can, if we acquire a producing property, we can deduct under Section 83 A our exploration and drilling expense and now our acquisition costs?

MR. LARSEN: Right.

MR. STEWART: There is nothing corresponding to that in the United States?

MR. LARSEN: Not immediate write-off of acquisition costs.

MR. STEWART: Nor on explorations and drilling expense?

MR. LARSEN: Exploration and drilling expenses can be written off immediately. Maybe I should qualify this by saying direct drilling costs become immediate write-offs. Certain aspects of reconnaissance of land, short of drilling, are immediately capitalizable.

MR. STEWART: All right.

MR. LARSEN: I am talking about such things as gravity work and seismograph work that would be initially capitalized.

MR. STEWART: So far as non-producing properties are concerned, or it may be this applies as well to the drilling expense with regard to producing properties. Let us take one at a time. Let us take acquisition costs and exploration and drilling expense with regard to non-producing properties. As I understand it these are treated as a current expense as they are incurred, but if the particular company incurs losses in the year in question, they can simply be carried back or forward according to the normal rules with regard to losses carried forward.

MR. LARSEN: In the States this is correct.

MR. STEWART: Now, would the same apply to those expenses with regard to producing properties which can be treated as current expenses?

MR. LARSEN: That is right. There is no concept of a body of separate tax credits. It is all encompassed in the profit and loss position.

THE CHAIRMAN: There is one part of that I do not fully understand, and that is acquisition costs may be written off at the greater of cost or percentage depletion.

MR. STEWART: I think, Mr. Chairman, we will come back to that.

THE CHAIRMAN: I don't see how you can cross the two.

MR. STEWART: I think this is a matter we can discuss when we get to the legitimate subject of depletion, but my understanding is in the United States you have a choice when it comes to depletion. You take

the higher of the two things. One is cost depletion on the unit of production basis, and the other is a percentage of gross production which is 27½ per cent, with a limitation of 50 per cent of net income from the particular property.

Is that broadly the situation?

MR. LARSEN: Yes.

THE CHAIRMAN: And the higher means the higher charge year by year?

MR. LARSEN: Year by year and property by property.

THE CHAIRMAN: So that you can take your choice in regard to each property?

MR. LARSEN: I believe that is correct. I might elaborate a little bit. Depletion is applied on property on a current basis and then each year you run your calculation and you take your choice.

MR. STEWART: I think the significance of Mr. Larsen's earlier answer, Mr. Chairman, was that these items which we permit to be deducted under Section 83 A which under the American practice have to be capitalized, can of course in the United States be recovered through the operation of the depletion system.

MR. LARSEN: Right.

THE CHAIRMAN: That is what I was getting at.

MR. STEWART: Broadly speaking, Mr. Larsen, it would appear to me that the present Canadian treatment of exploration and drilling expense and land acquisition costs is more generous or more liberal than the American system, looking at it from the point of view of the

taxpayer.

MR. LARSEN: In the sense that an earlier deduction may be taken.

MR. STEWART: I would like to get your reaction to this: Could I ask first of all if you are familiar with what I think is a very recent publication of the Canadian Institute of Chartered Accountants, entitled "Accounting Problems in the Oil and Gas Industry", written I think by a group under the leadership of Professor W. V. Coutts. Are any of you familiar with this particular book?

I would like to show you in particular an extract from Pages 50 and 51 of that book, and so that you will have the context, those pages are taken from section 12, which is the last section of the book, and is entitled "Summary and Conclusions".

At the bottom of Page 49 there is a heading "Oil and Gas Industry", and there is a paragraph beginning at the bottom of that page which goes over to the top of Page 50, which I might read.

Before reading it, I might say that the earlier part of Section 12 describes the conclusions they came to on the general function of accounting in relation to the petroleum industry. I do not think I need bother you with that at this moment. The paragraph I referred to, after summarizing their conclusions on this general point, reads as follows: "In accordance with the above conclusion, the problems of the industry have been analysed and evaluated by the standard applicable to the industry in general and certain conclusions have been

drawn. The result has been a series of recommendations" -- we are now at the top of Page 50 -- "Regarding the treatment of income items in the accounts of these companies. These recommendations may be summarized as follows."

I do not think I need bother you at the moment with the recommendations 1 and 2, but I think it might be worthwhile to take the time to read 3 to 7, because you have not seen them before.

"3. The principal asset of an oil and gas company is its reserves of oil and gas in the ground. The expenditures incurred to find and develop these reserves, (called in this Study, "pre-production expenses"), are performed only for the purpose of obtaining access to them and they are, therefore, all essentially the same in nature. Accordingly, all the costs incurred in finding or developing reserves whether they are ostensibly for lands, rights, geological and geophysical exploration or for the drilling of wells should be treated in the same way and capitalized as part of the cost of the reserves ultimately developed."

And you will see there is a reference there to Section 6, which is the sectionof the booklet which goes into the general subject summarized in recommendation 3 in some detail.

"4. Since not all reserves of oil and gas are identical, some recognition must be given

"to the variation in costs between different fields or pools. In the absence of any significant logical or physical relationship, the best unit for the accumulation of costs is the "area of interest". All expenses should, therefore, be allocated to an "area of interest" where they will be accumulated until the quantity of oil or gas resulting from the expenditures is known. Occasionally, it may be necessary to subdivide an "area of interest" when it is found that pools or fields of diverse characteristics have been included. Occasionally, no reserves will be found and the total costs assigned to that area will have to be charged to expense. Otherwise, all costs will be capitalized as part of the cost of the reserves included in one or other area of interest until written off through a depletion or amortization charge on the sale of oil or gas from the area."

Then there is a cross-reference to Section 7.

"5. Carrying charges on undeveloped properties (lease rentals, mineral taxes, etc.) are essentially identical in nature to the other pre-production expenses. They should, therefore, be treated in the same way, i.e., capitalized as part of the capitalized cost of the reserves developed

"in the appropriate area of interest."

And then they refer to Section 8.

"6. Once the reserves found in an area of interest are reasonably determined and the development work largely completed, the costs allocated to the area of interest should be related to the reserves established in order to get a unit cost for the reserves. These costs should then be matched against revenues by means of a depletion or amortization charge based on the number of units produced in the period."

And there is reference there to Section 9.

"7. The proper measurement of income requires a transfer of income tax expense between periods whenever a cost allowed for income tax purposes in one year is recorded in income account in another. The application of this principle to the account of an oil and gas company is perfectly feasible and the procedure, therefore, should be applied to these companies. Because of the operation of the depletion allowance, at present 33-1/3% of net income, the amount of the tax saving to be allocated in respect of excess claims for capital cost allowance or for exploration and development expenses will be based on two-thirds of the amount of the extra expenses."

That refers to Section 10. Now, if this is the first time

you have seen this, my next question may be, but I hope it is not, an unfair question. If you think it is, I will not press it, and I will simply ask you to let us have your comments on it in due course.

Would you be inclined to concur in the accounting treatment for corporate purposes which is recommended in paragraphs 3 to 7 which I have just read?

MR. BUCHANAN: Mr. Stewart, myself, I do have some knowledge of this study being conducted, If I might just recollect a little bit of them, Professor Coutts, as I recall, was doing this study under the sponsorship of the Canadian Tax Foundation. Is that correct?

MR. STEWART: Well, according to the preamble to this booklet, a study group of chartered accountants, some of them practising accountants and some of them in the oil industry, who were residents in Calgary, was formed by the Accounting and Auditing Research Committee of the Canadian Institute. The names of the members of that study group are set out here. There are six who were engaged in practice and six representatives from industry. After the group had met for some time they brought Professor Coutts into the operation to review the existing practices, and the reasons for those practices.

MR. LARSEN: My recollection of the recommendation of the Committee at large was that they did not have a recommendation because they could not get together on it. Am I not correct?

MR. STEWATT: I cannot answer that one, Mr. Buchanan. On one of the early pages in this booklet it is expressly stated that a study like this expresses the views of the effort or the study group concerned and does not reflect the approval or the endorsement of the Institute nor the Committee on Auditing research.

On a page at the beginning it describes the study group and this statement is made: "The Study Group has found the product of Professor Coutt's research to be both helpful and stimulating. After considering it at some length, and comparing the principles and practices which it advocates with other available methods, the majority of the Study Group considers that it offers an approach to the problem of resolving the many practices in effect that well merit further consideration. In particular, it is felt that further consideration should be given by the Study Group to accounting for 'tax savings' in oil company financial statements and in determining an 'area of interest'."

I suppose that that might be based on a qualified endorsement by the group of views expressed.

MR. BUCHANAN: That is my recollection of it. I haven't been personally involved in it. I do recall that there were considerable discussions on it within this group and so forth and quite a number of different concepts that were being developed.

The thought behind the study itself is one of financial statement presentation more to the shareholder and the investment people themselves through the opportunity of variations that exist to-day in the

presentation within the oil industry of their financial statement. I couldn't go beyond that as far as getting involved in the study itself because I know nothing beyond that on it.

MR. STEWART: Perhaps I could leave it this way: if on reflection there are any conclusions or recommendations in paragraphs 3 to 7 here with which you violently disagree perhaps you would let the Secretary of the Commission know. Would you mind doing that?

MR. BUCHANAN: Yes, we can do that.

MR. STEWART: I may have spent too much time on this but it was of interest to me because it would seem to indicate that the taxation treatment of these exploration and drilling expenses and land acquisition costs is very much more liberal than strict accounting practice for corporate purposes would apparently regard as appropriate.

Would you comment on this whether that is so or not? Do you think Section 83 A is of great value and assistance to the petroleum industry?

MR. BUCHANAN: It certainly does accelerate the write-off of certain of these costs and to that extent defers the tax liability.

MR. STEWART: Certain alternatives to Section 83 A approach have been suggested from time to time.

One is that expenses of this nature should be treated as capital cost for capital cost allowance purposes and written off under the capital cost allowance

system. Another suggestion is that these expenses should be accumulated and amortized over the period of production.

Would there be any question as to whether you would prefer the present system or either of those alternatives?

MR. BUCHANAN: I believe generally speaking we prefer the present system as far as the accelerated write-off is concerned. Many of the costs involved, of course, we certainly consider as being a direct expense of a going concern business or operation and as such under either treatment would be classified as an expense item and therefore written off in the year in which it was incurred.

MR. STEWART: I would like to come to some of the specific points with regard to Section 83A which were dealt with in this shorter submission.

I don't think I need dwell on the points you make in paragraph 1 to 4. In Paragraph 5 you refer to sub-sections (4b) and (4c) of Section 83 A My understanding of the point that you make there is this: That a corporation other than whose principal business is petroleum and an individual can now deduct from petroleum income exploration and drilling expenses and land acquisition costs. It cannot deduct under this Section 83 A item from the proceeds of sale of petroleum properties, of rights, under sub-section (5c).

MR. BUCHANAN: That is correct.

MR. STEWART: And you indicate, and it seems

to me to be so, that this seems an anomalous situation. Have you been able to find any explanation for it?

MR. BUCHANAN: We feel ourselves it was an oversight in the legislation, the problem being in these Sections(4b) and (4c) the fact that the key words in there are that these deductions could only be made from income from operation. Well, we feel it hard to believe such rights could fall into that category and therefore disallowed. We don't believe that was the intent of the legislation. The matters we brought forth are those submitted to the Government in the hope they would clarify these types of technical points or inequalities that exist in the present legislation.

MR. STEWART: I take it these points were raised after the 1962 amendments came in. You indicate here you wrote the Minister under date of March 20, 1963 and, of course, they have not been given effect because Section 83 A( ) was not amended, certainly in respect to what you deal with, in the new Bill.

MR. BUCHANAN: That is correct. There was

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no indication, of course, in the Budget Resolutions last April, nor would we expect this type of thing would be put forth within the Budget Resolutions. It is something normally confined to the Act of Legislation and the Bill that makes it effective. This Bill is on the way through now. I believe it is in the Senate.

MR. STEWART: As a matter of historical record I believe it passed the Senate without amendment last night.

Now I don't think I need deal with your paragraph 6 but in paragraph 7 you raise certain points with regard to sub-section (5a). I would like to discuss them a little bit and also raise one or two other points about that particular sub-section.

Your first point, as I understand it, is with reference to the words in sub-section (5a) "Petroleum, natural gas or other related hydrocarbons except coal". You think that may be unduly limiting and that if under a particular arrangement the right in fact exists to take other minerals or gases the particular arrangement may cease to be within or may never be within the sub-section. Is that the situation?

MR. BUCHANAN: That is a literal interpretation. This is what we are concerned with.

MR. STEWART: Now in your industry when you acquire rights ordinarily are they restricted to petroleum and natural gas or other related hydrocarbons or are they wide open as far as mineral rights and petroleum rights are concerned?

MR. BUCHANAN: This would vary on the type of lease involved depending whether you are dealing with the Crown or freeholders. I don't believe I can answer specifically. Certainly there are many times when we have available to us under our leases mineral rights beyond those contemplated by this Section.

MR. STEWART: Then you refer in particular to hydrogen sulphide and helium. Are these the instances which are of most concern to you?

MR. BUCHANAN: They are the two specific

items that come to mind. We didn't endeavour to go beyond that.

MR. STEWART: You don't know of any other major ones which should be considered?

MR. HOTCHKISS: Carbondioxide, I suppose.

MR. MITCHELL: There are other substances and perhaps some to-day which are not recognized as being of significant value which could come into the picure later. These two are the prime ones. I would not say they are exclusively the items.

MR. STEWART: Have you been able to determine since your letter was written what interpretations the Department is making of those particular words.

MR. BUCHANAN: We have had no response from the Government whatever.

MR. STEWART: You don't know from experience in the industry whether those words "petroleum, natural gas, and other related hydrocarbons" are being interpreted by the Department widely or narrowly.

MR. BUCHANAN: No, we have no experience to date.

MR. STEWART: Then your second point at the bottom of Page 4 of this submission is that this sub-section(5a) applies simply to rights, licences, or privileges to explore for or drill for or take these substances. You point out that in certain circumstances a taxpayer may acquire not the right to take but an interest in the proceeds or net profits from production.

Now you suggest sub-section (5a) should be extended to cover an acquisition of that type of interest.

Now do you consider that such extension is consistent with the general framework of Section 83 A ?

If you look at sub-section (3b) it permits a deduction in respect of drilling and exploration expenses, including all general geological and geophysical expenses incurred by the taxpayer on or in respect of exploring or drilling for petroleum and natural gas.

Now does that mean that this deduction is available for the active explorer and not for the holder of some interest in proceeds or in net profits, which is the type of person with which this particular point is concerned?

MR. BUCHANAN: I can see your point, Mr. Stewart. Our thought on it, as we are dealing with it primarily from the industry standpoint, this is one more minor point of the overall industry itself where we are participating towards a common endeavour. In some instances the properties involved might be farmed out to other parties and over-ride obtained or possibly sold to another party with this over-ride retained.

MR. STEWART: You would not suggest deduction under (5a) should extend to anyone who was not entitled to a deduction under (3b). Now when I say that that may not be put very accurately. What I mean is this: if we have a corporation which is entitled to a deduction under (3b), which I think is now the basic section for companies whose principal business is in the petroleum field, that type of corporation is clearly entitled to the benefit of (5a), but if you have someone who' is not entitled to take exploration and drilling expenses

under the earlier provisions of Section 83 A I take it you would not suggest you should be entitled to a deduction of the (5a) type.

MR. BUCHANAN: I would say in our opinion there would be no rule to differentiate in this matter involved here. It is relatively minor in regard to the major category which pertains to the purchase or acquisition and the related write-off of the costs that might be incurred there.

MR. STEWART: Then I would like to ask you this about sub-section (5a): about half way down, after the words "petroleum and natural gas and other related hydrocarbons except coal" we find this "under which agreement, contract, or arrangement there was not acquired any other right to, over or in respect of the land in respect of which such rights, licence or privilege was so acquired except the right to enter upon, use and occupy so much of the land as may be necessary for the purpose of exploiting such right, licence or privilege."

Can you tell me what the purpose of that restrictive wording was? Why are they so concerned about the interest in land which was acquired under the particular arrangement?

MR. BUCHANAN: We have nothing that would indicate to us the reasons for that restriction. It has been intimated to us there are possibly other areas outside the oil industry itself to which this Section is still applicable. I am thinking of other mining ventures.

MR. STEWART: Have you any idea, for example, if (5a) would apply if there is an arrangement under which you acquire the petroleum right and the surface rights necessary to permit you to exploit and also some depreciable assets.

MR. BUCHANAN: This legal interpretation has certainly been taken by respective counsels of various companies involved and they are so setting up various agreements and arrangements in such a manner that in the event that interpretation is taken we are avoiding the possibility.

MR. STEWART: I take it, Mr. Buchanan, the wording of sub-section (5a) has affected the terms of sale agreement and corresponding documents and that such documents may now differein terms from the corresponding documents which were entered into before this provision came into effect.

MR. BUCHANAN: That is correct.

MR. HOTCHKISS: There is a lot of disagreement on this point. I think you would get one opinion from one source and one from another on which way it should be handled. There is a confusion.

MR. STEWART: Again do I take it that the practice of the Tax Authorities on this point has not been crystalized as far as you know?

MR. HOTCHKISS: I couldn't answer that. In our experience it has not been.

MR. BUCHANAN: This legislation has been in effect such a short time there is nothing historically on it that we can go on as to the interpretation the

Departments are placing on it.

MR. STEWART: We are getting to the point where it has been enforce some little time. The applicable resolutions were introduced in April, 1962, and the Bill was enacted a year ago. Now we have had a full year in which to struggle on these 1962 amendments.

MR. BUCHANAN: The actual legislation came out in November, 1962. 1963 is the first full year that this legislation applies to and, of course, there has been no tax returns as such really filed which are applicable. We have yet to find out how this is going to be handled.'

MR. STEWART: I would like to ask you another point about sub-sections (5a) and the related sub-sections.

Sub-section (5a) says that if you acquire rights under an agreement of what we might call the (5a) type, whatever that type may be, you get a deduction. Sub-section (5b) says that if you sell rights you must bring the proceeds into income. Sub-section (5c) is to the same effect as it relates to different categories of taxpayers.

Then we come to (5d) and (5d) seems to say that you bring proceeds into income under (5b) only if the property has been acquired under a (5a) type of arrangement.

It seems to be quite material to know whether the type of conveyancing that went on prior to April 10, 1962 produced the (5a) type of agreement.

MR. BUCHANAN: That is correct. (5e) has its

application there as well and is pretty significant in view of the fact even though you do dispose of other assets as such along with it it would be deemed that you have sold these mineral rights involved and a corresponding amount received would be taxable income.

MR. STEWART: I took it from what you said earlier that the industry as a whole is not sure what the (5a) type of agreement is and therefore cannot tell exactly what the effect of (5e) (c) and (d) is.

MR. BUCHANAN: That is correct. This is a very important point to us because we do not know how it is going to affect us on our current operations and how it effects the future operations is very important in our overall business plan.

MR. STEWART: Then moving on to paragraph 8 of your submission you deal there with sub-sections (5d) and (5c) which we have already referred to in another connection.

As I understand what you say in Paragraph 8 it is this: non arms-lengths disposition of rights must apparently now be carried out on a fair market value basis. That is the first point you make.

MR. BUCHANAN: That is correct.

MR. STEWART: The second point is that (5a) may not tie in particularly well with sub-section 80.

MR. BUCHANAN: That is correct.

MR. STEWART: Now you suggest that (5a) should apply only if properties are acquired or rights are acquired in an arms-length transaction.

MR. BUCHANAN: That is correct.

MR. STEWART: Would you also contemplate that (5b) would apply only if the sale was an arms-length transaction?

MR. BUCHANAN: Yes.

MR. STEWART: This would be the corollary?

MR. BUCHANAN: Yes. We are looking at both sides, write-off and income possibility.

MR. STEWART: Basically I take it what you are suggesting is if a transaction is not an arms-length it should not be necessary to put it through or carry it out at fair market value.

MR. BUCHANAN: That is correct. Basically all that is involved is overall economics and efficiency of your operation itself. Obviously if it is advantageous and more economical to consolidate your operation into one corporate entity presumably that should be done. There is no reason basically to our knowledge why there should be any tax benefit involved in going through it and thus requiring you to maintain a separate corporate entity for tax reasons alone.

MR. STEWART: If the parties to a non-arms-length transaction wanted to put a transaction through at fair market value they should be prohibited from doing so.

MR. BUCHANAN: That is one alternative. The suggestion made is it should be an option between the respective parties.

MR. STEWART: Well, if we adopted your suggestion, Mr. Buchanan, I wonder if there might be any untoward consequences as far as the revenue is

concerned. Let us suppose that we have a parent and a wholly owned subsidiary and the parent wishes to sell or decides to sell assets, sell petroleum rights to the subsidiary, your suggestion would be that the parent would not have to bring the proceeds of disposition in if the transaction was put through at a nominal amount. I take it that the subsidiary would obtain no deduction in respect of that acquisition.

MR. BUCHANAN: That is correct.

MR. STEWART: If the parent subsequently sold the shares of the subsidiary to somebody else, and the subsidiary was then wound up into its new parent, again without any tax consequence, we would be in this position that the original parent had transferred these assets to the new parent without having to bring the proceeds into income, but I suppose the new parent might not be too attracted by this particular transaction if it was not getting a deduction in respect of the assets acquired.

MR. BUCHANAN: I think, Mr. Stewart, what we dealt with here was more a winding-up of the subsidiary itself. This is basically what is in mind in this 17 (6) section. There are already provisions in the Act under 8 (a) and 8 (b) where there are limitations and restrictions placed as to the available write-off. Any write-offs available within these companies is restricted to the income available from the properties of such companies.

MR. STEWART: I think I should make this point to you, that one question which this Commission and its staff will obviously have to consider is the general question whether non-arms lengths transactions should or should not be required to be put through at fair market value.

Your point relates simply to one type of transaction which will have to be considered under the principles involved. I think anyone who has to deal with a group of companies, which includes a parent and a number of wholly-owned subsidiaries, is sympathetic

with your ideas that transfers between the companies should be permitted to be carried out at less than fair market value if the parties wish to proceed that way. However, there are problems which arise in this regard from the point of view of taxation and revenue, and basically what you are saying is that you think in this type of transaction as long as the acquiring company does not get a deduction, the disposing company should not be required to bring the proceeds in.

MR. BUCHANAN: That is correct. We realize here that we are dealing here primarily with the general principle of this area and this is what we are suggesting. As far as specific legislation that might be necessary to put this into effect, we recognize that there probably would be exceptions where it would be either inequitable to the companies, to the industry concerned, or to the Government from a revenue standpoint, and these sort of things might have to be recongized in the actual effect of legislation.

THE CHAIRMAN: Mr. Stewart, when you get to a suitable spot, I think we will break for a minute or two.

MR. STEWART: This will be convenient.

---Short Recess.

MR. STEWART: Gentlemen, I would like now to move to paragraph 9 of your shorter submission. As I understand that paragraph, you are suggesting that the proceeds of sale of oil rights should be treated as production income for the purposes of the

depletion allowance. Is that the substance of it?

MR BUCHANAN: That is correct, Mr. Stewart.

MR. STEWART: Can I ask you this: let us suppose that Company A owns a property or owns certain petroleum rights which it sells to Company B for, let us say, one million dollars. Company B then proceeds with whatever further development is required, and in fact produces oil from the properties concerned on a scale which justifies the payment of one million dollars for the properties.

I take it then that there is no question but that Company B would be entitled to deplete or to the depletion allowance on the production from the properties?

MR. BUCHANAN: That is correct.

MR. STEWART: So that does it follow from your suggestion that both Company A and Company B would be entitled to take depletion in respect of what was essentially the same reserves?

MR. BUCHANAN: That is correct, Mr. Stewart. In total the depletion available would be exactly the same regardless of whether it stayed with one company or whether it moved into the second company.

MR. STEWART: Why would it be exactly the same? Let us suppose that it develops that there are 1 million barrels of crude in this particular property, and these are sold for one million dollars. On your basis, as I understand it, Company A would get depletion if it was in an income-tax-paying condition, it would get depletion on one million dollars, and Company B

would also get depletion on one million dollars.

MR. BUCHANAN: Not on the million. In the second instance. Any depletion is only calculated on the net income involved after deduction of 83A expenses. Where Company A got it on the million in hthe first instance, Company B would not get it until it recaptured that one million dollars.

MR. STEWART: Your point is that Company B's section 83 A expense would be increased by one million dollars, and it would have to absorb that expense before it could take depletion.

MR. BUCHANAN: Or be entitled to depletion, that is correct.

MR. STEWART: We have assumed so far that the rights are acquired under a (5a) type of arrangement. Suppose this sale is not under a (5a) type of arrangement, then we would be in this position that Company A would bring the proceeds into income -- I beg your pardon, let me put this case to you. I am not quite sure where it is going to lead us. Let's suppose that Company A acquired these rights under an arrangement which did not come under (5a). When it sells the rights to Company B for one million dollars, it may be the case under the combined effect of (5b) and (5d) that Company A does not have to bring the proceeds into income.

MR. BUCHANAN: That is correct.

MR. STEWART: For tax purposes. However, it would nevertheless on your basis receive the depletion allowance in respect of what it received.

MR. BUCHANAN: The reference here and the

intent is that we are dealing with acquisitions under (5a).

MR. HOTCHKISS: How could it not come under (5a)?

MR. STEWART: Mr. Hotchkiss, if you will tell me what a (5a) type of agreement is, I could answer that one better.

MR. HOTCHKISS: We don't know, but we think it covers any purchase of producing property. I realize, and we know from experience there is a good deal of confusion on this, but I think the general interpretation being taken is it is the purchase of property acquired after April 10, 1962 -- drilling and exploration expence to anybody who purchased it.

MR. STEWART: I will abandon that particular series of questions. Your basic point is that if Company A sells to Company B for one million dollars, there will not be duplicate depletion or multiple depletion in respect of the same reserves because the purchaser will have to deduct the cost of acquisition under (5a); will be entitled to deduct because (5a) is firstly permissible. I beg your pardon, it is mandatory, "the amount paid shall be deemed to be a drilling and exploration expense."

Now, suppose on the other hand we change our system of depletion in the way you suggest at a later stage, and we are dealing with percentage depletion based on gross revenue, under my example if the proceeds of sale were treated as production income to Company A, would you still consider it should be entitled

to depletion?

MR. BUCHANAN: No, Mr. Stewart. This is because of the existing legislation and the fact that we are on net depletion basis to-day in our calculations. However, if we are dealing with a gross basis, then it has no direct effect on your available depletion as such. Therefore there would be no need for this depletion allowance to be applied to income derived from (5b).

MR. STEWART: I think we will have to give some further thought here to your first proposal under Paragraph 9 so as to ensure that there could not be a double or a multiple depletion in respect of the same reserves. I take it you would agree that that would not be an appropriate result.

MR. BUCHANAN: I might just clarify here for a moment, Mr. Stewart, that the intent of this second brief that is submitted here is one of bringing to your attention these outstanding items that in our minds should be clarified within existing legislation as it stands to-day, and in essence is really divorced from the primary brief that we have submitted to you to-day.

These are matters which we have mentioned that we have brought to the Department, and we were hoping by the time we were before this Commission they would be rectified. However, such is not the case.

MR. STEWART: Also under Paragraph 9 you suggest or you make another point. You deal with the

case where a sale is of properties which do not contain proven reserves. You say in that type of case you would consider that the cost of acquisition of the rights should be deductible from the proceeds of sale for purposes of sub-section (5b). Is that what it comes down to?

MR. BUCHANAN: Mr. Stewart, will you just clarify that for me?

MR. STEWART: Yes. In the opening part of Paragraph 9 it seems to relate to the question we have just discussed which relates to depletion. You say at the top of Page 7, "It should be pointed out that this treatment contemplates the disposition of properties which have been proven to contain oil and gas reserves as it is only under these circumstances that the sale price would be based on reserves in place which would give rise to their depletion allowance to the previous owner if the properties were not sold."

Up until now we have apparently been dealing with dispositions of properties which contain proven reserves. Then you go on and say, "Except in these circumstances, the sale of the property is merely a trading transaction in prospective petroleum or natural gas rights. It would not be logical to allow depletion allowance on such sales but the seller should be allowed to deduct the cost of such rights not otherwise deductible under the recent amendments to Section 83 A up to the amount of the proceeds from the disposition of the rights."

Now, my question is this: you are suggesting

here that if properties which do not contain proven reserves are sold with the result that the seller must bring proceeds into income under (5b), he should be permitted to deduct his acquisition costs. Is that the effect of what you are saying?

MR. BUCHANAN: Yes, we are dealing primarily with this April 10, 1962 date involved here. Naturally there are many properties that we have as of to-day who have paid these acquisition costs in the past which are not allowed in the existing legislation. Yet the income on sale of these properties is taxable income. Therefore we are dealing here more specifically with the concept that such expenses are really incurred to earn income, and therefore they should be deductible.

MR. STEWART: I am not quite clear why you say this deduction of acquisition costs should be permitted only in respect of properties which do not contain proven reserves. Why should this not apply on all dispositions?

MR. BUCHANAN: I believe it was our intent that it should apply to all.

MR. STEWART: I see. I have simply misread this part of your submission. Then let me ask you to consider this hypothetical case, Mr. Buchanan, or gentlemen. I would like you to think of our old friends, Company A and Company B, that Company A we will assume has a property acquired before 1962 at a cost of $15,000.00. Company B also has a property it acquired before 1962 at a cost of $25,000.00.

Let us now suppose for the purpose of this

hypothetical example that each of these properties today has a fair market value of $50,000.00. Now, as the law stands if A and B in effect exchange those properties for $50,000.00 each, would the proposition be, and let us take Company A first, he would have to bring $50,000.00 into income, let us assume, and he would not get any deduction in respect of his $15,000.00 cost. Is that correct?

MR. BUCHANAN: That is correct.

MR. STEWART: When he buys Company B's property for $50,000.00, he gets a deduction under (5a) of $50,000.00, so that he has got a property for $50,000.00, and he has sold a property for $50,000.00, and for tax purposes this is a stand-off; is that correct?

MR. BUCHANAN: Correct.

MR. STEWART: By the same token, I think there would be a stand-off as far as B is concerned; he would have a deduction of $50,000.00, and he would have income of $50,000,00, and there would again be a stand-off. Are we agreed?

Now, let us suppose we effect the change which you are suggesting, and that each A and B are entitled to a deduction of his cost of property from the proceeds of sale. The amount that A would have to bring into income would be $50,000.00, less the $15,000.00, so he would bring in $35.000.00. Is that correct?

MR. BUCHANAN: Correct.

MR. STEWART: He would obtain a deduction in respect of the purchase from B of $50,000.00; is that

correct?

MR. BUCHANAN: Yes, that is right.

MR. STEWART: So that he would have a net deduction as a result of this exchange of properties of $15,000.00? Are you with me so far?

MR. BUCHANAN: Yes, I think so.

MR. STEWART: I think if you apply the same reasoning to B you will find that he will have a net deduction from income of $25.000.00.

Now if this is correct, Mr. Buchanan, and please don't think that I am suggesting to you that it necessarily is, because I find the application of these provisions somewhat difficult, but if this is correct then if this rule that you suggest is put into effect it would seem to me there might be a good deal of swapping of properties acquired before 1962.

The parties to the swap would have the benefit of deductions which they do not now have.

MR. HOTCHKISS: Would they not continue to have the deductions if they continued to hold the property?

MR. STEWART: They would not have deductions under Section 83 (A).

I would like to leave that with you as a tentative example of the difficulties that might arise. I don't say they do but it seems to me at the moment they do and if you conclude with reflection that this reasoning is incorrect I hope again that you will write the Commission and say so. We want to be sure that we are getting down to the bottom of this thing.

MR. LARSEN: I wonder if I might make one statement on that?

MR. STEWART: Please do?

MR. LARSEN: Your conclusion, I believe, is correct. They would by swapping properties in effect create the kind of deduction for properties acquired prior to 1962 that they would have gotten after the 1962 amendment.

MR. STEWART: Yes.

MR. LARSEN: I would like to draw the example which I believe raises this question. We deal with a client who has acquired for two million dollars the property prior to the 1962 change for which he receives no tax reduction. Perhaps even through circumstances beyond his immediate control. He needs to sell that property, let us say, for two million dollars. We will assume no drilling credit is available and so forth. To change a tax law at that tpoint lost him ' roughly one-half the value of his property. That, I think, is the type of example this was meant to reflect on.

MR. STEWART: Mr. Larsen, I would not suggest for a moment there have not been cases of hardship arising under these 1962 amendments. I have just been trying to determine what the effect of this particular change would be. While it would help the type of fellow that you refer to it may be that sub-section (5b) is as broad as it is because of concern on the part of the tax authorities that unless they made it as tough as they have made it there would be what they regard as an undue drain on the revenue.

MR. LARSEN: I understand your question. I just wanted to put the other example in the record.

MR. STEWART: Now in Paragraph 10 of your submission you refer to farm-outs. You suggest the legislation might be further amended to cover the farm-out type of situation. I take it that the basic concern is that if the owner of petroleum rights does grant a farm-out you want to be sure that he is

in no way subject to tax by virtue of the fact that the farmee agrees to drill or spend monies on the property on which he takes the farm-out. Is that it?

MR. BUCHANAN: That is correct. The section refers to receipt of consideration. That is what gives rise to the point. At the time the Bill was passed it certainly was ratified as far as the intent was concerned and even expressed in Hansard itself. I don't think there is doubt about intent. We are concerned about any legal interpretations this might take since this is the intent and we felt it preferrable from our standpoint that it be part of the legislation, part of the Bill itself.

MR. STEWART: Then I have looked at Paragraph 11 and I have also looked at the 1962 Statute which amended Section 83 A , and in particular amended sub-section (8a). That 1962 Statute, Section 19 seems to state quite clearly that the amendments to sub-section (8a), except for the amendment of the last five lines of the sub-section would be applicable to the 1962 and subsequent taxation years. The change of the last five lines would be applicable to taxation years ending after April 10, 1962. The proposal you make in Paragraph 11 would seem to me to be quite contrary to the expressed provisions of the 1962 amendments.

MR. BUCHANAN: This section (8a) was intended to in effect recognize any expenses incurred by these previous companies and so forth and really to make it retroactive back to 1955 through 1961, to which it was not applicable. Our problem area here is in

certain instances the production during the intervening years through 1955 -- 1961 has been such that there is not sufficient income left at this point to offset the costs that are now being allowed under this section.

Now this, we understand, was not the intent of the legislation but it is the manner in which the Department itself is acting under this legislation.

MR. STEWART: You mean in practice they are giving effect to your interpretation?

MR. BUCHANAN: No, they are saying it is recognized only from 1962 onward. The intent, as we understood it, was it was to apply back to the 1954 legislation and in effect recognition could be given to those costs involved and applied against previous income.

MR. STEWART: Anyway, Mr. Buchanan, I am sure you would agree Section 83 A contains different rules for different periods of time in a great many respects.

MR. BUCHANAN: Yes, I must agree with that statement. This is contradictory to that extent as we understood it.

MR. STEWART: Then in Paragraph 12 you summarize the effect of the 1962 amendments and you suggest that they affect the independent companies more than the majors because they eliminate a means of obtaining funds for exploration purposes. Is that right?

MR. HOTCHKISS: I think that affects certain companies. I might add something. What we are getting at is, as we stated in our summary, reduced funds from

the United States sources because of the application of these changes, particularly with respect to sales by individuals or non-qualified corporations. They are in the unhappy position that if they acquire a property and sell it they cannot use their cost.

We have covered this earlier in the brief. I think you have agreed this is an anomalous situation but nevertheless it exists for companies who use that sort of capital. I think it has been a very serious deterent. What you are saying to the person is: if you make an investment in Canada as an individual or a non-qualifying corporation you are taxable on the gross proceeds regardless of the costs. You might spend a million dollars on a property and sell it for a million dollars, indeed liquidity is one test to any investment, it would be taxable on the million as ordinary income.

Consider the case of the American investor where that same transaction would be a capital gain, He, of course, is subject to much higher Canadian tax and he is not going to spend money here under those circumstances.

MR. STEWART: In his opening statement Mr. Mitchell was referring to the 1962 amendment which affected American individuals. He was referring to those Canadian amendments and not the American amendments?

MR. HOTCHKISS: That is correct. We have found this to be quite a serious problem combined with certain other problems in this same area.

MR. STEWART: I observe that you do say on towards the end of paragraph 12, the second last

sentence: "Tax considerations are not normally a major factor in take-overs by large integrated companies."

This is so notwithstanding the 1962 amendments? Is that your feeling?

MR. HOTCHKISS: Perhaps someone else should speak on that point.

MR. LARSEN: Perhaps I would read the wrong sense into the answer on this. In a transaction in a take-over of a large company, whether it is by way of asset purchase or by way of shares and liquidation, we are now looking at a seller who has properties that would be taxable on a sale. Assuming that the major companies are large taxpayers they can pay a larger price for the properties since on the purchase they also would receive an equal reduction in their own tax bill for that same year.

Now you translate the purchaser in a company not now paying taxes, he then would have in a sense in his purchase price to provide some funds for the taxability on the sale, but his reduction in tax would be deferred to the day when he is paying tax. Therefore it is a sort of unequal competition to the acquisition of those properties.

I am not sure if this is the exact meaning of the statement. This is what it suggests to me.

MR. STEWART: I think what you have said is perhaps an extension of what you said here. If we start a couple of sentences earlier on we are dealing with the seller and we say that sellers are in a worse position now because they have to bring the proceeds

of sale into income.

You also make the point because the proceeds of sale have to be brought into income you cannot consolidate companies as easily as before, which has the effect of efficiency.

Then your next statement seems to be perfectly general and dealing not with the position of the vendor or the seller but with the position of the purchaser. You talk about large integrated companies taking over other companies and you seem to suggest that when they are taking over other companies they don't treat taxes as a major factor. You go on and say they regard general economic factors as more important.

MR. LARSEN: Maybe I should refrain from answering further.

MR. STEWART: Is there any other comment on that particular point? If not I will move on.

I think it is perhaps unnecessary here to deal with your Paragraph 13 because we deal with depletion when we come to the other submission. I think that perhaps the same would apply to Paragraph 14, which is one of the matters that is dealt with in the other submission.

Paragraph 15 relates to the combined effect of sub-sections (8a) and (8d). You are suggesting in effect that under (8d) we do not talk about second successor corporations but we talk about successor corporations generally. Is that what it comes down to?

MR. BUCHANAN: That is right. We have no

knowledge why there should be a limitation on the second successor approach. Why not a third or fourth? We see no reason if it is applicable in the first and second it should not be in the third.

MR. STEWART: You would not accept the fact there would be any accounting problems in applying the benefit of (8d) to a series of successors.

MR. BUCHANAN: There are the usual normal ones. This is something you inherit and they recognize this as being in existence. It is an obligation that exists and for that reason alone there is no reason it should not be prevented.

MR. STEWART: In Paragraph 16 you deal with the question of advance rulings. I don't think it is necessary to go into that at all.

Let me ask you now some general questions with regard to the effect of these 1962 amendments. Can you say whether the passing of these 1962 amendments has had any effect on the prices of petroleum properties in Western Canada?

MR. MITCHELL: We did not detect any noticeable trend in prices. The possibility is that there is some upward revision but the many other variables involved make it difficult of analysis at this time.

MR. STEWART: This applies to both Crown sales and private transactions, Mr. Mitchell?

MR. MITCHELL: My comments pertain largely to Crown sales. Private transactions are normally kept, just as the word implies, reasonably private. The Crown sales are of course published.

MR. HOTCHKISS: I think, Mr. Stewart, the majority of the transactions have been by the share route. Perhaps the others can correct me if I am wrong. This is done rather than taking advantage of the direct property acquisition.

One of the problems is the position of the seller. It is quite advantageous to the buyer but in this you have got a large 83 (A) loss. It could be a disadvantage to the seller. Lots of people like to buy property. Not very many people selling properties in my opinion.

MR. STEWART: You have been talking about private transactions in properties.

MR. HOTCHKISS: Yes, sir.

MR. STEWART: You are really distinguishing, I take it, between two types of take-over. You might have a take-over of shares or a purchase of all the assets subject to the liabilities of the company. One effect of these amendments, you think, has been to increase the share take-overs at the expense of asset take-overs.

MR. HOTCHKISS: I don't necessarily say that. I think there have been more follow that route but whether more now than before the amendment I would not want to say.

MR. STEWART: The reason there may not have been as many large-scale asset purchases as otherwise might have been because the seller would have a tax problem on the sale?

MR. HOTCHKISS: Right.

MR. STEWART: As the purchaser of shares does not get a deduction in respect of the cost of the shares will he pay less for shares than he would have paid for assets?

MR. HOTCHKISS: I would think that might be a factor. I would like to hear a comment from the others.

MR. MITCHELL: I would agree with that suggestion, Mr. Stewart. Certainly it has to be a factor.

MR. STEWART: I think it was suggested when the legislation was introduced that one of the purposes of the legislation might be to prevent take-overs. Can you comment on that?

MR. MITCHELL: In my judgment the legislation has not succeeded in preventing take-overs. I seriously doubt whether it has even had the influence of reducing the number of take-overs. This is a matter of judgment. There are many variables involved but it is my conclusion.

MR. STEWART: From what has been said earlier you think that on balance it may have led to more shares take-overs as opposed to asset take-overs than normally expected.

MR. MITCHELL: Oh, yes. I would say this would be a tendency, the reluctance of the seller.

THE CHAIRMAN: I am not very clear why it would have been thought this legislation, which has the right to deduct acquisition costs, would have discouraged take-overs. I would have thought it would have made properties more valuable. Even though the transactions are shared the price of the sale of shares

is equated to the properties. I would have thought persons would be prepared to pay more for properties they could deduct.

Is it the higher price they are prepared to pay, the basic value of the properties, so they are not so likely to be taken over? Is that the reason?

MR. STEWART: As I understand it, Mr. Chairman, these gentlemen feel that the owner of properties is not as likely to sell them when he has to bring the proceeds into income as he would have been before the amendments when he could sell on a straight capital gains basis.

Now I think they have also said that they would expect that a purchaser would pay less for his shares than he would be prepared to pay for the underlying assets because when he buys shares he does not get a deduction.

THE CHAIRMAN: He would equate the value of shares to the value of the properties, I would assume. Just as many transactions for companies are offered at two prices. One if one buys shares and one if one buys assets.

MR. STEWART: I think there may be this factor: let us suppose that the company whose shares you were buying has a limited carry-forward under Section 83 A. In other words, its properties were acquired perhaps essentially before 1962 with the result they never did have a deduction in respect of their line acquisition costs.

If the purchaser in those circumstances could

buy the properties he would get a deduction based on the current market value of the properties.

If he buys the shares he is buying the shares of a company which may be in a tax position or very close to the tax position.

Is this the type of thing that goes on?

MR. MITCHELL: Yes, I would say that is what goes on.

THE CHAIRMAN: It depends on the position of the vendor or purchaser if they have a taxable inome or not.

MR. MITCHELL: Each of the positions would influence the transaction. The time of use of possible tax credit would be critical. I think it is reasonable to state that one could equate a share purchase to an asset purchase in any transaction. I think there is a definite tendency to look more at the shares over which the seller is not interested in incurring substantial tax liability at the time of sale.

THE CHAIRMAN: Why was this legislation thought to discourage take-overs?

MR. STEWART: As far as properties are concerned, Mr. Chairman, I suppose because it would prevent, for the reason just mentioned, a number of Canadians from selling properties because of the tax consequences.

THE CHAIRMAN: They could sell shares.

MR. STEWART: They could sell shares, that is true.

THE CHAIRMAN: I don't see why because it discourages them from selling properties there would

likely be less take-overs.

MR. BUCHANAN: It is a line we don't concur with. It is a matter that was touched upon earlier and was really another attempt to perhaps make it more difficult for sales. These things by and large do not succeed. The forces of business perhaps still prevail somehow.

THE CHAIRMAN: Thank you.

MR. STEWART: Could we go back for a moment to Crown sales. When your companies are bidding at a Crown sale you presumably take into account everything you know or can find out about the property you are bidding on. I am sure that would be so.

MR. MITCHELL: Yes, sir.

MR. STEWART: Do you not also take into account the general tax climate in which your companies are carrying on their operations.

MR. MITCHELL: Absolutely.

MR. STEWART: So when in 1962 you found you were going to get a new deduction in respect of land acquisition costs this would be material when you came to consider a particular Crown sale.

MR. MITCHELL: Yes, material perhaps in a direct sense if a corporation is then in a position of paying tax at a particular time. Material in the indirect sense in preventing the competitive bid that might be necessary.

MR. STEWART: Therefore in determining your bid you would to-day have regard to the fact that whatever you paid was going to be deductible for tax purposes.

MR. MITCHELL: Yes, certainly this would be the normal type of analysis for corporations, and some of them will find this quite significant, and others will find it of little significance indeed, depending on their tax position.

MR. STEWART: If they were the ones who found it significant, would there not be a tendancy to bid more once the deduction is available than they would bid if it were not?

MR. MITCHELL: Yes, sir, that would be the case, and I think perhaps it would apply in your earlier case. The tendancy would normally be in the direction of increase in prices. An analysis of this in making it a positive statement that such has actually occurred is a little difficult to do because of the very many variants involved, but I think upward trends would be anticipated and may in fact have actually occurred, but I could not testify definitely that it has done so.

MR. STEWART: I would be interested if you would comment on this, Mr. Mitchell: if it is so, are we in this position that the granting of this particular deduction may involve principal payments of the sort from the Federal Government to the Provincial Governments? The Federal Government is granting a new deduction. The effect of this is to increase the

amounts which the industry will pay to the Provincial Government on Crown sales.

MR. MITCHELL: Such an assumption may be correct insofar as mineral rights are held by the provinces. I would point out there are mineral rights held by the Federal Government, perhaps of growing import, to the oil exploration scene. I would add, too, that the amount of this transfer, if that is the term you used, may be indeed rather small on the overall scheme of things.

As has already been commented, it is difficult to analyse, but if you are looking and asking is this a possibility, I would agree.

MR. STEWART: Well, I will come back to this possibility later because when we come to consider the return on investment in this industry, I think I will again put the question to you, must we not take into account in a number of respects the basic tax climate in which you are operating.

However, I will not press that question now. One other thing that was suggested when the 1962 amendments were introduced, was that they might make possible in Canada financing arrangements of a type which I think are known in the United States as the A-B-C type of deal. Are you familiar with that expression, the A-B-C type?

MR. MITCHELL: I am familiar with it and Mr. Larsen is much more familiar with it.

MR. STEWART: Have you any evidence that this has in fact happened? Has the A-B-C- type of deal now

migrated to Canada?

MR. LARSEN: On the general overall principle, it is now possible in that the A-B-C deal involves an intermediate company who buys a certain amount of oil in place, and receives in return sufficient amounts of production to cover what he paid, plus an interest factor.

This is now possible in Canada under the present legislation.

MR. STEWART: I suppose it is inhibited to some extent because of the fact the seller must put the proceeds --

MR. LARSEN: I would say there is no tax benefit involved as in the United States on the A-B-C due to the overall difference in tax law. In other words, it is possible it does not create a different overall taxability.

MR. STEWART: Have you heard of very many cases in which it has been used in Canada in the last year?

MR. LARSEN: I have been told there is one in progress now.

MR. STEWART: But that is the first you have heard of it?

MR. LARSEN: I think the main sense it is used is you can in effect sell without creating balance sheet debt versus plain borrowing. It is sometimes used for that purpose.

MR. STEWART: This deal that you believe is now current is the first one you have heard of in

Canada?

MR. LARSEN: As far as I am personally concerned, yes.

MR. STEWART: Now, Mr. Chairman, that concludes my questions on Section 83A.

THE CHAIRMAN: I would like to stay with that for a minute or two. Before moving away from the A-B-C deal, if there were one done in Canada, would a U.S. resident secure more advantage by being a party to it, and I cannot tell you which party, whether it is the A,B or C, but being a party to it in the financing, than a Canadian would?

MR. LARSEN: I don't know that there would be -- that he would have any more benefit from the financing aspects, but if he has Canadian properties and is in a major sense an American taxpayer, he might translate the Canadian A-B-C deal into a U.S. --

THE CHAIRMAN: Into a U.S. capital gain?

MR. LARSEN: Yes.

THE CHAIRMAN: One question that occurs to me with regard to acquisition costs, in the case of the purchase of Crown lands, this would seem to me to put the purchaser who has sufficiently substantial income to deduct acquisition costs immediately, at a distinct advantage over those who were not in such a position. Therefore it would cause the wealthy companies to be in a position where they could well afford to outbid the less wealthy, and therefore the properties would tend to go in the one direction. Am I right in that?

MR. MITCHELL: This certainly would be the tendency, that the company able to take immediate advantage of the tax position should have a greater value to the same property than one that does not. As between, let us say, wealthy and the non-wealthy.

THE CHAIRMAN: Using "wealthy" meaning income?

MR. MITCHELL: In terms of income, immediate income, taxable income, yes.

MR. STEWART: In other words, each taxpayer will take into account his own individual circumstances, and if he is in a tax-paying position he might pay more for properties than if he were not in a tax-paying position.

MR. MITCHELL: Yes. Some companies may be big or small. They may be Canadian-owned or non-Canadian owned, but their wealth, using the term as current income, would certainly be an important factor.

THE CHAIRMAN: Mr. Stewart, you drew attention to the matter of accounting by making reference to a booklet of the Canadian Institute of Chartered Accountants. You were seeking to compare the accounting there with the full deduction permitted under Section 83A I think?

MR. STEWART: Yes, Mr. Chairman.

THE CHAIRMAN: It seems to me that Section 83A permits deductions for tax purposes which are in the main greater in any one year than would be taken under usual accounting, and I am not referring to the bulletin of the C.I.C.A., and I do not know that there is something that one could call "usual", but I think

in a general way perhaps there is. I believe that it is customary for good accounting to capitalize expenditures in respect of producing wells and to write-off immediately the cost expended on dry holes? Is that correct in a broad way?

MR. BUCHANAN: Yes, that is right, Mr. Chairman.

THE CHAIRMAN: Therefore, Section 83A, which permits deduction from taxable income of all costs, woul cause more weighted deductions from income than would normally apply under good accounting, whereas successful holes would be capitalized, am I correct?

MR. BUCHANAN: That is right, sir.

THE CHAIRMAN: To what extent would the variations occur in the normal company? Of course it depends on the drilling programme and the success and all kinds of things, but I would expect in a substantial company earning regular income that difference would be very substantial, would it not? They would be capitalizing a lot on their books which would not be capitalized for tax purposes?

MR. BUCHANAN: Yes, that is right. It varies with individual companies and the stage of production they happen to be in. You made reference to good accounting concept. This presumably is more frequently related to the individual companies to the stage of development on exploration they happen to be in. I assume they are using the proper concept in their own eyes.

THE CHAIRMAN: But not all the same?

MR. BUCHANAN: Definitely not.

THE CHAIRMAN: For the moment that is all I can think of concerning 83 A, Mr. Stewart. Let us proceed.

MR. STEWART: Gentlemen, I would like to go to the question of depletion, and we therefore move to your other submission. This is a submission which is packed with interest. I am afraid that my questions are going to be relatively prosaic and confined or largely concerned with some technical questions on tax structure, but it may well be after I have finished or as I go along the Members of the Commission will have other more general questions.

Now, just trying to summarize the situation this submission seems to proceed on this basic premise that a depletion allowance in this country at any rate in existing circumstances is essentially incentive legislation which is designed or should be designed to provide an adequate rate of return to the investor and to encourage new capital to come in. Is that an over-simplification of the situation?

MR. PEARCE: I would agree with your statement.

MR. STEWART: Now I take it from what has already been said with regard to Section 83A, or under our discussion of Section 83A, that general approach is subject to this, that the depletion allowance in this country may permit the recovery of certain costs which are not in fact recoverable under 83A, or the capital cost allowance system, the exact amount of which we do not know, but which Mr. Buchanan has estimated at seven hundred and fifty million dollars. Is that

right?

MR. PEARCE: I am not quite sure of the point of your question.

MR. STEWART: Well, my point is this: if we accept for the moment this figure of seven hundred and fifty millions dollars which cannot be recovered under either Section 83A or has not been -- let us leave it that way, cannot be recovered under Section 83A -- or capital cost allowance, this expenditure may be recovered or credited through the operation of the depletion system? Is that correct?

MR. BUCHANAN: It would mean in effect that is what must be accomplished in view of past debts and charges that are part of the cost of our operation, and in some manner should have been allowed as a cost of the operation.

MR. STEWART: Well then I think you have certain criticisms of the present depletion allowance in Canada. One of them is, and I think this will be found at Page VII - 2 and VII - 3 of your submission, one of your criticisms is that the present allowance is based on production income, and that in the computation of production income you must deduct your Section 83A expense. Is that so?

MR. BUCHANAN: That is correct, Mr. Stewart.

MR. STEWART: Now, of course since 1962, Section 83A expense has included the cost of newly acquired rights. I think Mr. Pearce, if you would not mind, rather than nodding if you agree or disagree, if you would say so, so that the reporter can take it

down.

MR. PEARCE: Yes.

MR. STEWART: You point out that because of these deductions in the computation of production income, depletion is deferred.

MR. PEARCE: To the extent that -- what is the last part of your question?

MR. STEWART: While these deductions still have to be made, you do not in fact have the benefit of the depletion allowance.

MR. PEARCE: That is correct.

MR. STEWART: Of course while these deductions are being made you also do not have to pay tax?

MR. PEARCE: But you still have a tax liability of a deferred nature.

THE CHAIRMAN: That is something I hope you will explore later. I do not fully understand it.

MR. STEWART: This might be an appropriate time, Mr. Chairman, to ask Mr. Pearce to enlarge on that. Why do you say that while you are deducting under Section 83 A you have a deferred tax liability?

MR. PEARCE: Well, I think that can be answered in this way: looking at the industry as being -- not continuing to be in a growing stage, that eventually the individual companies will be in a taxable position, and as a result of having at some point of time levelled off their exploration and development activities, used up all their tax credits, and therefore will be in a taxable position.

MR. BUCHANAN: We have a form of accelerated

allowance being allowed to us, and therefore in fact the costs that are applicable to these operations are being applied to-day, and yet there is a tax liability that still exists as such, and those credits that are applied to-day are not available to us later.

This has been suggested in this outline that you distributed to us earlier.

MR. STEWART: This is really the point dealt with in recommendation number 7.

MR. BUCHANAN: That is right. So this tax liability really exists. There is no tax payable to-day because of accelerated write-offs, but the liability does exist in the future.

THE CHAIRMAN: This is a liability, of course, contingent upon continuing profits into the future. If there are no profits, there are not taxes to be paid.

MR. BUCHANAN: That is correct. No tax is being paid to-day.

THE CHAIRMAN: On an ordinary commercial accounting these reserves are usually considered to be deferred credits rather than liabliities for the reason that they are levelling out of matching costs against income. One hesitates I think to call them liabilities, because they will only be paid if in future profits are made which will be taxed. One can't see the future.

MR. BUCHANAN: That is correct as far as the reserves that have been developed to date and the revenue that is to be derived therefrom. There certainly

is a tax liability in that area.

Now, as far as future tax payable is concerned, if there is any elimination of that tax to-day, it is because of the continuing exploration and development, what we are doing in the future which in effect defers this to the future.

MR. STEWART: Then I observe at Page VII - 5 of your brief you suggest that depletion based on net profits does not act as an incentive for Canadian companies.

You go on to say "companies which are not in a taxable position do not receive a depletion allowance. In general the more active company is in exploration, the less benefit it will obtain from the present depletion allowances."

Do you suggest that the present system has the effect of discouraging exploration?

MR. PEARCE: I think in answering that question we should look at the present supply and future demand for Canadian crude oil. As we see it in our projections and in projections that have been made by reliable sources, the demand for Canadian crude oil will continue to increase in the future. Probably by the end of the sixties we will require more crude oil reserves than we have to-day to meet that expanded demand.

This means even though the industry is in an over-supply, or could be considered as in a temporary over-supply position as far as reserves are concerned, unless we find substantial additional reserves, we will

not be able to meet this growing demand in the future. I think we have pointed out in the report that it is in the public interest that we be in a position to supply this demand.

Now, under the present depletion allowance, particularly as it applies to non-integrated companies, they are not in a position to gain the benefit of depletion, and therefore there could be a tendancy that they would concentrate on developing present resources rather than continuing an active exploration programme.

MR. STEWART: I take it that it is generally agreed that one result of the present system is that the deduction of Section 83 A expense in computing production income not only defers depletion but results in complete loss of depletion because you do not have any depletion credit to carry forward after Section 83 A( ) expense has been utilized.

MR. BUCHANAN: That is correct, Mr. Stewart.

MR. STEWART: When you said, Mr. Mitchell, said I think it was earlier on, that there might be about six independents in the Canadian industry which have paid dividends, and that those dividends would have been on a relatively small scale, would you have any idea as to how many of the independents would have been able to claim depletion to date for tax purposes?

MR. BUCHANAN: On a net depletion basis; the existing legislation you are referring to?

MR. STEWART: Yes.

MR. BUCHANAN: I do not think we can give you a factual answer to that, Mr. Stewart. We haven't covered

that area with background material.

MR. STEWART: Would there be many?

MR. BUCHANAN: Very few would be my estimate.

MR. STEWART: I have the impression from one of the earlier hearings we had when we were discussing this question, that one of the larger companies in the industry thought even among integrated companies there would be very few which had been able to claim depletion for tax purposes.

MR. PEARCE: There is an indication in the Taxation Statistics Document put out by the Department of National Revenue on the dollar amount of depletion claim.

MR. STEWART: Which edition?

MR. PEARCE: The latest one I have is 1962, which of course reports only 1960 information.

MR. STEWART: What page are you on, Mr. Pearce?

MR. PEARCE: It is on page 117. The amount is four million dollars as reported here for companies in profit class classification, profit category, 1.4 million dollars for companies in what they classify as a loss category.

THE CHAIRMAN: Is this depletion?

MR. PEARCE: Right. This category, of course, does not include integrated companies which are reported in a separate category under petroleum refinerers. This is as I understand it.

THE CHAIRMAN: The loss category, it is only companies that declared losses.

MR. PEARCE: In a non-taxable position or paid no tax.

THE CHAIRMAN: I do not see how depletion applies.

MR. PEARCE: Well, I would imagine that they claimed - there was some companies in that year that claimed a total of 1.4 million dollars of depletion that resulted in their not being in a taxable position for that year, and they are placed in a category as defined here.

THE CHAIRMAN: That is a most curious thing. Depletion is a portion of taxable income.

MR. STEWART: It is a portion of production income.

THE CHAIRMAN: Yes, production income. I think I have the point.

MR. BUCHANAN: I do have here a submission made by an independent association in 1962 to the Honourable Donald Fleming, Minister of Finance at that time, and in this submission itself -- we had made this survey of the independents which related to this specific question. We did get answers to our questionnaires that were sent out from a total of 59 companies, and for the period from 1949 to 1960, these companies deducted a total of six million dollars, round figures, from their income during that 12-year period.

THE CHAIRMAN: That is half a million dollars a year on the average?

MR. BUCHANAN: That would be correct. So it would be very significant of the benefit derived by the independents particularly under this present depletion regulation.

MR. STEWART: In 1960, according to those figures, the independents in the aggregate took 5.4 million dollars.

MR. PEARCE: If that is the taxation statistic -- I don't think you can relate that to independents themselves.

MR. STEWART: I think, Mr. Pearce, that independent companies were dealt with elsewhere.

MR. PEARCE: As I understand it from correspondence with the Department of National Revenue there is one company that would be normally classified as integrated that operate a subsidiary producing company. That is classified in this category on Page 117 rather than under the category of petroleum refiners.

MR. STEWART: Do you happen to know, Mr. Pearce, where you find the particulars of the refining companies?

MR. PEARCE: That is at Page 134.

MR. STEWART: And how much depletion did they take in?

MR. PEARCE: 11.2 million dollars for the profit category, 4.1 million dollars for the loss category.

MR. STEWART: Thank you. Now we discussed

earlier on the American system and I think we were agreed as to the basis of depletion allowances in the United States and that in the United States certain write-offs are obtained through the depletion allowances. Perhaps that is a wrong way of putting it. In the United States you do not get as liberal a deduction in respect of certain of the exploration and drilling expenses as you do in Canada.

Now your proposal, as I understand it, is this: I understand that it is based on the proposition that the petroleum industry is subject to greater risks than the other extractive industries. I see that suggested on Page VII - 6.

Your suggestion is in Canada we switch to an alternative system of depletion allowances and that the allowance be 25 per cent of gross incomes.

MR. PEARCE: Right. Gross producing incomes.

MR. STEWART: In the computation of that income it should not be necessary to deduct exploration and drilling expenses.

MR. PEARCE: Correct.

MR. STEWART: You appear to place no limitation on that proposition at all. There is no limitation as to the total profits from the production or anything of that sort.

MR. PEARCE: No, we did not put any limitation on it. We were looking at it from what you might call the concept point of view. The advantage we see is an incentive to increase the interest in exploration. We are dealing primarily with the difference between

the present 33 -1/3 per cent base on net compared with the proposed 25 per cent on gross. We didn't explore any limitation.

MR. STEWART: If we look at Table VII - 2 on your submission we find that you have compared the effect of the present system and your proposed system and at the bottom of the page I observe that the depletion allowance under your proposal would be considerably greater than under the existing system with the result that the profit after tax under your proposal exceeds the profit after tax under the existing system.

MR. PEARCE: That is correct.

MR. STEWART: Turning over the page you deal with the period of deferment of income tax 7.3 years, whereas under your system the period of deferment would be 10.8 years, which is a period which is about 50 per cent longer.

MR. PEARCE: I would agree on the order of 40 per cent, in that area somewhere.

MR. STEWART: Going back to Page VII - 9 you seem to reach the conclusion that even on your basis the cash flow in the Canadian industry, or rather that income on a cash flow basis, on a discounted cash flow approach, would be no greater than it was in 1960 at any rate for the other extractive industries.

THE CHAIRMAN: I got lost at one point here. I understand what "deferred" means with regard to 83 A(costs. I understand the relationship. I do not understand why there is a deferment brought about by depletion. Are we going to come to that later or should I understand

it at first glance.

MR. STEWART: I think we should try and clear these things as we go along.

MR. PEARCE: I think I might answer your question in my explanation of the two tables.

THE CHAIRMAN: Very good. That is where I got lost. Would you bear that in mind as you explain your tables.

MR. PEARCE: I can appreciate the reason why. It is difficult to follow through these tables. We did not include the work sheets which possibly would have made it much easier to follow through. We did not feel it would be possible in view of the size. We would be pleased to turn copies of the work sheets over to the Commission staff if you would like to have them.

As far as Table VII - 2 is concerned, which you referred to, we were attempting to prepare a hypothetical example based on the present reserve discovery between 1947 - 1962 and based on the average cost and average revenue per barrel and we attempt to arrive at a rate of return.

Now in the second Table you refer to we were using the latest data, the 1962 information, which should reflect the increase in activity in the industry as a result of the national oil policy and increased export of gas to the United States.

In other words, we wanted to see if it provided any different information than the average for the period.

Now on Table VII - 3 under the gross depletion proposal there will be a contribution or a cash flow of one dollar and sixty-seven cents a barrel.

Now in the gross depletion example, because gross depletion would be a first charge against income tax -- again I would like to emphasize we are using a hypothetical example -- in other words we assume that there would be no continued exploration from this point on. We try to determine the effect of using up of the exploration and drilling credits so that under the 25 per cent gross allowance there would be a period of 10.8 years in which income taxes would be deferred as a result of deduction of exploration and drilling costs.

MR. STEWART: Mr. Pearce, could I ask this to make sure I understand it: on the right-hand column on the Table VII - 3 after deducting from your cash flow your capital cost allowance and your depletion allowance and your gross depletion allowance you have a balance of $1.077 and you have a Section 83 A carry-forward of $11.68, which will take care of the $1.077 for a period of 10.8 years.

MR. PEARCE: Right.

THE CHAIRMAN: The 55.7 cents comes from away further back in your submission where you worked out the total cost over a period of time.

MR. STEWART: You get an average of 55.7 cents. We have 21 years here. We have a value of $11.68.

MR. PEARCE: Dividing $11.68 by $1.077.

MR. STEWART: In the next column to the left

you reflected the effect under the existing system. You cannot claim any depletion until Section 83A extent is used up so the same figure of $11.068 is used up over a much shorter period of 7.3 years.

MR. PEARCE: That is correct. Referring back to Page VII - 9 that you referred to earlier this is where we show a summary of our discount of cash flow calculations to see the effect of the further deferral tax under the gross depletion basis.

We also looked at it from the point of view of the present reserve to production ratio of 21 years compared with 15 years, which we assumed earlier the industry might work down to by about the early 1970's.

MR. BUCHANAN: If I might point out one other matter concerning Table VII - 3. These two calculations in essence were done for solely one purpose. They are using the basic 1962 value itself and in the first instance the 33 - 1/3 per cent net. We are dealing with the existing legislation in view of the overall deficit position of the industry as far as excess of expenditures made as opposed to revenue received.

We show nothing as far as the 33-1/3 per cent is concerned whereas the 25 per cent gross we are showing it as it would be under our proposal here.

The purpose of this Table then is to take the two situations and show the respective cash flow involved. Thus from that determine the number of years the tax would be diverted. Under 33-1/3 per cent -- 7.3; 25 per cent -- 10.8.

This is the sole purpose of the Table. We

take respective annual figures and go back to Section 7, Page 9, and in our indicative analysis here on the 33-1/3 per cent as opposed to 25 per cent we are saying in it 7 years and 11 years, which corresponds to the 7.3 and 10.8 reflected in the previous table.

THE CHAIRMAN: When one uses the word "deferred" it implies something put off to another day and it seems to me that those figures at the bottom, 7.3 and 10.8, represent the length of time before, under these circumstances, the taxpayer will commence to pay taxes. He is not going to pay the taxes which have been postponed. It is the period over which he is tax exempt in fact.

MR. BUCHANAN: That is correct. This reflected the overall industry statistics. As you understand the individual companies themselves, of course, will press for their own position within the category.

In total we are trying to demonstrate to you just the essential net effect of the proposed change to the gross depletion as opposed to the existing legislation with the 33-1/3 per cent net approach.

THE CHAIRMAN: I understand that. I have always taken "deferred" to mean "postponement". I don't think that is what it means here.

COMMISSIONER PERRY: You are reading it to mean during this period the liability accumulated which ultimately must be met in full. That is not the case. The ultimate liability will relate to the earnings of the years remaining after the period.

THE CHAIRMAN: This means a period of tax exemption.

MR. BUCHANAN: There is still tax liability which must be paid some day. This is what we are referring to in Table VII - 2. We show provision for deferred tax which in fact must be paid some day in the future.

That liability exists with each barrel produced to-day. Because of the accelerated write-offs we do have under Section 83 A it is deferred or postponed.

THE CHAIRMAN: I am considering deferment with regard to 83 A expenses. That is certainly a deferment. You will have to meet that liability. I accept that but I don't think your depletion causes deferment. I think depletion is a matter of exemption from tax. I can accept 83 A as deferment.

MR. BUCHANAN: We have mentioned earlier although the present regulations exist there is no effective depletion being received by many of us. In that instance with the gross depletion which would be automatically available to us through calculation of that depletion on gross income, to that extent we would receive benefit of depletion, and those not using up Section 83 A expenses. That is the reason for deferment.

THE CHAIRMAN: I think you have made the point that by virtue of gross depletion you push off 83 A expenses and further defer. In deferring you are dealing with some amount of liability at the end of both periods.

MR. BUCHANAN: That is correct.

MR. STEWART: You are on Section 83 A

expenses. But is there a basic difference here between the two systems of gross and net. Under the net system, the current system you have production which you are never permitted to take depletion on.

MR. BUCHANAN: That is correct.

MR. STEWART: Whereas under the gross system you do get depletion whenever you have production.

MR. BUCHANAN: That is correct, sir.

MR. STEWART: Now, I don't think that this is directly related to this question of deferred taxation, Mr. Chairman, but it does seem to me to be a material distinction between the two systems.

THE CHAIRMAN: I think you are right, I wonder if we could consider that while we eat lunch. I would like to stop at this time and come back at 2:20. We will stand over until 2:20.

---The hearing was then adjourned until 2:20 P.M.

MR. STEWART: Now, gentlemen, returning to this larger submission of yours, I observe that on Page VII-10 you set out at the top of the page how a 25 per cent gross depletion allowance would assist your industries. Then in the bottom half of the page you suggest that we could switch to this type of depletion allowance without materially affecting the corporate income tax paid by the industry at the present time.

I would like to raise some points about this alternative system which you suggest, and I come back to the fact, first of all, that you do not contemplate that there would be any limitation on the 25 per cent gross rate. I remind you that under the American system there are two alternatives; one is cost depletion, and one is gross depletion. That is 27½ per cent of gross revenue, property by property with 50 per cent of taxable income limitation.

Now, if you have no such limitation at all, are you not suggesting an allowance which is materially more favourable than even the American allowance?

MR. PEARCE: I think there is one distinction between the Canadian depletion allowance proposed and the American depletion allowance in the United States. As I understand it, it is a property by property basis, which has an advantage over a company's total operations for the year.

MR. STEWART: Your system is, I suppose, essentially on a well by well basis; isn't it?

MR. PEARCE: The proposed 25 per cent?

MR. STEWART: Yes.

MR. PEARCE: It would be on the total producing income for the year.

MR. STEWART: But producing income before any Section 83A( ) deduction.

MR. PEARCE: That is right.

MR. STEWART: And with no limitation as to production or other profits.

MR. PEARCE: That is right.

THE CHAIRMAN: There would not be any difference then, I don't think between the U.S. and Canadian because of the well by well if one does not deduct any 83A( ) expenses. I wouldn't think it would make any difference whether it was on a well by well basis or all together; am I right?

MR. PEARCE: Where it is based on a property by property, your allowance is not penalized for the reason you might be exploring one area without success compared with exploration or development operation in another area where you are receiving producing income.

COMMISSIONER WALLS: Excuse me for interrupting, Mr. Stewart, but I am not quite clear. At one stage we are talking about a well by well basis and now you are talking about property by property.

THE CHAIRMAN: I think that is my fault. They were talking about property by property, and I mentioned the well by well. I think we assumed they are talking about property by property.

MR. STEWART: Now, Mr. Pearce, you say in the United States it is $27\frac{1}{2}$ per cent of gross income with a limit of 50 per cent of taxable income property by

property.

MR. PEARCE: Correct.

MR. STEWART: Your proposal is that we take 25 per cent of gross income, of gross production income, and what deductions do you envisage would be made in determination of that income, it being understood that you are talking about the income of the company as a whole, and not property by property. What deductions do you make in the computation of production income?

MR. PEARCE: I think that is shown in exhibits VII - 2 and VII - 3.

MR. BUCHANAN: Mr. Stewart, to answer your question on that, we are proposing that this be on a straight gross production basis. There would be no deductions whatever involved. In our opening remarks on Page 5 of this Section VII we make reference to that, that there are a number of alternates available to us as to which route this could go. We have chosen the straight gross approach, one of the reasons being the elimination of many of the administrative problems involved both to the limited company itself and to the Tax Department.

Our Brief itself stipulates that we feel we require a minimum of 25 per cent gross, so if for any reason there was any other alternative approach contemplated, the benefits to be derived from that to the industry would have to be comparable in our estimation.

THE CHAIRMAN: Mr. Stewart told me they deducted royalties on Table VII - 2.

MR. STEWART: I don't think this is the system

they are suggesting.

MR. BUCHANAN: We are dealing with income to the company, and where there is royalty income involved, it would go direct to the Crown or to the freeholder, or whoever it happened to be, so we are dealing with income to the company.

MR. STEWART: Then on Table VII - 2,after deduction of royalties, you have a line, net revenue before expense, and then you take off operating expenses, but your depletion is taken on the net revenue before expenses.

MR. BUCHANAN: That is right. The 2.088 figure.

MR. STEWART: So that was I not correct in suggesting that on this basis except as regards royalties we do not need -- the result is simply the aggregate of the allowances, 25 per cent allowances in respect of each producing well?

MR. BUCHANAN: You are suggesting it would be necessary to go back to the individual well basis?

MR. STEWART: No. We were mentioning the fact in the United States you determine this on a property by property basis. Now here there is a limitation with respect to the taxable income from the particular property. Here under your system, as I understand it at the moment, you simply take total proceeds of production, total production income, and you can say if you like that you are looking at it as a whole, but you get exactly the same result if you take production from each well and add those amounts together.

MR. BUCHANAN: There would be no need to go to the property by property route.

MR. STEWART: No, as a matter of administrative work, you presumably would just take the total.

MR. BUCHANAN: Yes.

MR. STEWART: Have you by any chance seen the Brief which was filed with this Commission by the Imperial Oil Company?

MR. PEARCE: We have referred to it. I have not studied it very closely.

MR. STEWART: My recollection is that in that brief they propose that we switch to a depletion allowance based on 25 per cent of gross production income, but that we have a limitation of the total production profits of the particular company; and that tye conceded on examination that in determining total production profits, it would be appropriate to deduct Section 83A items.

Now, what comment would you make on a limitation of that sort?

MR. PEARCE: I haven't studied their proposal in detail. I would suggest that on that basis the return we feel that is required for the industry would not be high enough. In other words, I would like to reiterate that we in this approach have tried to determine a gross depletion allowance that, on a minimum basis, would give the industry, the independent industry, a rate of return approaching that of the other extracting industries.

Presumably if there were some other basis

for gross depletion, as Mr. Buchanan mentioned earlier, the rate would have to be somewhat different, depending on the limitation.

MR. STEWART: Do not the relative merits of the gross system and the net system to a particular company, depend on the extent or the proportion of its production revenue which it spends on further explorations?

MR. PEARCE: Well, I would think that is correct.

MR. STEWART: I wonder if you would comment on this: if we think of a company which is in a flat position, to make it easy; that is, when I say "flat" in this regard I mean at the beginning of a particular year it has no carry-forward of Section 83A expense. Would this be the fact that to such a company, 25 per cent of gross as a depletion allowance is equivalent to 33-1/3 per cent of net if the company spends 25 per cent of the gross on Section 83A items.

MR. BUCHANAN: I don't think that is quite correct, is it, Mr. Stewart? You are relating it to gross. If he spends 25 per cent of his gross revenue on operating expenses, then the 33-1/3 per cent net would be the equivalent of the 25 per cent gross approach.

MR. STEWART: Including operating expenses Section 83A items?

MR. BUCHANAN: No, excluding 83A.

THE CHAIRMAN: Are you using the word "gross" meaning taxable income before 83A expenses,

Mr. Stewart?

MR. STEWART: I am using it, Mr. Chairman, I think in the sense that these gentlemen are; certainly in the same sense as it is used in the United States.

MR. BUCHANAN: On this other point, if you would refer to Section VII, Page 9.

MR. STEWART: Yes.

MR. BUCHANAN: The Table at the top of the page there indicates the relative depletion that would be obtained under the 33-1/3 per cent concept as opposed to the 25 per cent gross which you see is essentially the same. 53 cents on one hand and 52 on the other.

MR. STEWART: Now, I would like to refer again to the pamphlet which I mentioned this morning, "Oil and Gas Production and Taxes", published this year by the Canadian Tax Foundation, and to a discussion which begins on Page 266 of that pamphlet. The object of this discussion which I refer to is to compare the tax effect resulting from the present 33-1/3 per cent net depletion allowance with the cash effects resulting from a gross depletion allowance at various percentages.

I don't suppose by any chance you have a copy of this pamphlet with you?

MR. BUCHANAN: We have one here.

MR. STEWART: If you would not mind looking at Page 267, there is a chart, and in the editorial part at the bottom of the page, it seems to be indicated that a company which spends 25 per cent of its gross income on exploration -- I beg your pardon, I see that

they are talking here about operations, development and exploration -- if you look at the bottom of the chart it says "percentage of gross income which is spent on operations, development and explorations", so that perhaps explains --

MR. BUCHANAN: It is not directly comparable.

MR. STEWART: Not directly comparable to what?

MR. BUCHANAN: To the situation you were demonstrating here earlier in that operating costs as such are included in this.

MR. STEWART: All right, I am afraid I had overlooked that. Let's start again. Would you agree with this: if a company that starts off in that flat position I mentioned spends 27 per cent of its gross income on operation, development and exploration, then 33-1/3 per cent net allowance works out exactly the same way as 25 per cent of the gross?

MR. BUCHANAN: Yes, that is right, and that happens to be the relation of our operating costs alone to the gross revenue after deduction of the royalty.

MR. STEWART: Where are you looking at the moment?

MR. BUCHANAN: I would refer to Table VII -2.

MR. STEWART: Yes.

MR. BUCHANAN: Our net revenue before expenses, 2.088.

MR. STEWART: Yes.

MR. BUCHANAN: Our operating expenses are

42 cents. That would be some 21 or 22 per cent.

MR. STEWART: It is about 20 per cent; not 25?

MR. BUCHANAN: Yes, you are right, sir.

MR. STEWART: In any event is the depletion allowance which is dealt with in this pamphlet, starting at Page 266 which is described as "a depletion allowance as a percentage of gross income", is that the type of depletion allowance that you are advocating? If you look at that chart on Page 267 on the left-hand side there is a reference to depletion allowance as a percentage of gross income. Is this your type?

MR. BUCHANAN: On the surface, Mr. Stewart, it would appear to be. I wouldn't want to answer that unqualified because we have not studied this particular pamphlet itself.

MR. STEWART: Let us proceed on the basis at the moment that it is your type, and if you wish to indicate after to-day that it is nnot, we will be very happy to have your qualifications.

I think it is the case there, and perhaps I am repeating myself, that a 25 per cent gross allowance of that sort produces the same result as 33-1/3 per cent net allowance, if 25 per cent of the gross income is spent on operation, development and exploration.

MR. BUCHANAN: Mr. Stewart, I hate to keep at this point, but just to make certain we are on common ground, you realize in these historical facts represented here, and so forth, the actual total of your operating development and exploration is much higher

than what they are using here.

MR. STEWART: I am talking now about a hypothetical company. I am not talking about your company. I am talking about a hypothetical one that starts off in a flat position.

MR. BUCHANAN: In our case this has been in excess of 50 per cent.

THE CHAIRMAN: Mr. Stewart, your formula is a slightly different one but if you start with taxable income before 83A expenses, and you spend 25 per cent of the taxable income on 83A expenses, a 25 per cent rate of gross is the same thing as a third of the net.

MR. STEWART: I think that is a neat way of expressing it, Mr. Chairman, yes. I am not sure that I would agree we are talking about taxable income, but I think that is equivalent. I think we are talking about income.

THE CHAIRMAN: I am quite happy to accept that, but it seems to me a little irrelevant to drag in gross and also operating expenses into this. I think it would be better to leave them out and start below that.

I can understand it easier that way.

MR. STEWART: All right, then I will try to proceed on that basis. It further appears from this material in this pamphlet I think, and I refer in particular to Chart No. 4 on Page 271, that where there is a limitation such as Imperial proposed of 100 per cent of net income, then if you spend from 25 per cent up to

75 per cent of your income on operating, development and exploration matters, a 25 per cent gross allowance is preferable to 33-1/3 per cent of net.

I think if you look at the editorial comment at the bottom of Page 270 you will see that that is borne out. The last sentence on Page 270.

MR. BUCHANAN: I would agree with that statement, Mr. Stewart.

MR. STEWART: Well, really, Mr. Buchanan, all I am getting at I think is this: under your proposed system the depletion allowance would be more favourable than the present system whenever, at any rate, 25 per cent or more of income was expended on operating, development and exploration items.

MR. BUCHANAN: That is correct, sir.

MR. STEWART: Now, I think the Imperial Oil representatives said to us that they suggested this 100 per cent of production profits limitation because they wanted to approximate the United States position. Whether their system would succeed or not, I can't say at the moment. In any event, as you have no limitation at all, your allowance is more favourable to the taxpayer than the U.S. system?

MR. BUCHANAN: That is correct. In this proposed estimate of theirs, of course, certainly there are problems arise in it as far as independents are concerned. If we take the situation where a company has a carry-forward position, would that not automatically eliminate any depletion allowance, or alternatively, if level-off exploration activities, section 83A expenses,

exceeded 75 per cent of your gross income, from that point forward there would be a reduction that would affect the depletion allowance. In that latter case there would be depletion, and that might be fine for a well-established company that has got solid revenue behind it, and your plans are to spend a specific amount of their income each year in looking for new reserves each year. The alternative to that is your smaller company that can't go out and find their reserves -- may not be supplied with such capital directly under their internal source of funds. Those companies would definitely be penalized.

MR. STEWART: Would it be the case that in a good many cases the smaller companies you are talking about would expend more than 75 per cent of income on additional exploration?

MR. BUCHANAN: Plus your development costs. If you expand that to include all your 83A expenses, I would say yes.

MR. STEWART: This would be quite a common thing?

MR. MITCHELL: I would say that is quite frequent, and of course again is a function of the state of the company's evaluation. The longer it has been established, the less apt it is to maintain that high percentage of expenditure.

Certainly many companies now have a high percentage, and those starting up would be faced with a similar situation.

MR. STEWART: Now, can I ask you two or three

questions about depletion allowances generally? Is the effect of a depletion allowance, whether it is gross or net, to stimulate production primarily rather than to stimulate exploration?

MR. PEARCE: I would think that the 25 per cent gross depletion allowance that we proposed would have the effect of increasing exploration, recognizing that down the line that would be reflected in production.

MR. STEWART: Do you think thereis any risk that an allowance based on production will lead to a development of proven acreage rather than exploration in the strict sense?

MR. PEARCE: Well, I think that the majority of the companies certainly are interested in being in the business. The only way they can assure this is to continue exploration in order to remain competitive. I would suggest they would continue to explore.

MR. STEWART: It has been suggested to me that in a province such as Alberta where you have a pro rationing system there may be a tendency under an allowance of this sort based on production to drill more development wells than is economically desirable. Would you comment on that proposition.

MR. MITCHELL: I would be glad to. There has been a tendency in the industry almost from the inception to develop more wells than were necessary. This tendency has been corrected gradually through the years and fortunately in Canada we have the benefit of misfortunes in other areas to consider before drafting our own regulations.

There will be at any time a slight tendency for over-development of properties. I really feel that the degree of success we have already attained in cutting down such over-development is quite high and this is not a problem of substantial magnitude that is now facing the industry.

MR. STEWART: Thank you very much, Mr. Mitchell. Going back for a moment to Page VII - 1 of your submission, you refer in the last couple of paragraphs on that page to a number of types of incentives other than the one you are recommending.

I think I can recall discussing one or more of these alternatives with another representative of your industry in this room a month or so ago, the British American Oil Company. I think their general approach to this was that the appropriate type of incentive was one which left it to the individual member of the industry to determine exactly how to run his own affairs and that therefore anything in the nature of a Government subsidy and so on should be ruled out.

What would your general approach be to that?

MR. PEARCE: Our reason for eliminating the subsidy is we felt it might not meet particularly the first criteria of those we consider important as far as selecting an appropriate incentive.

MR. STEWART: Take the second one of bonus to successful exploratory ventures. You rule that one out later on in the page as difficult to interpret or to record from an accounting point of view. Is that correct?

MR. PEARCE: That is correct. I think that would apply to a number of other alternatives listed there.

MR. STEWART: In any event having considered them all you prefer this one?

MR. PEARCE: I think it best fits the criteria and certainly I think it is the easiest to apply from the company's point of view and the Government's point of view.

THE CHAIRMAN: Do you think it time to

introduce another alternative?

MR. PEARCE: Yes, indeed.

THE CHAIRMAN: I would have thought if the objective is as stated to encourage development of expenditure that it should be directly geared to that. Now if you wish to encourage further capital expenditure we allow increased appreciation until we cannot go any further and then we add investment allowance. We allow a rate of 150 per cent.

Why, if we want to encourage development, do we not relate our encouragement directly to what we want? It would seem to me more effective and easier to administer and right exactly in line with what we are doing.

It would avoid the difficulty of explaining that the whole industry is going to be taxed at a lesser rate than the rest of the business community. I have always thought that pretty difficult to explain satisfactorily despite the risk. There are a lot of individual taxpayers who have a high risk too.

Why not relate the development expenditure to the incentive which is directed at development expenditure and if one gave an allowance of 150 per cent and you apply it to your schedule VII - 3 you will find it is a little better on this illustration than what you have presently achieved.

For every dollar you spend you allow two dollars deduction. You would get another .557 in place of .522.

It seems to me so obvious that somebody

must have thought of it and rejected it. Why was it rejected? I would be interested to know.

MR. PEARCE: I can only suggest, Mr. Chairman, that I don't think we have looked at all possible alternatives. I am sure there are others. These were the ones that appeared to us to be fairly obvious ones.

MR. BUCHANAN: Was .557 the reference?

THE CHAIRMAN: Am I right in that?

MR. BUCHANAN: Yes, that is correct. We are talking of all exploration and development costs where the incentive that was being referred to here was directed to exploration only. This enters into the areas of having to define what is exploration cost, which is not the simplest thing to do.

THE CHAIRMAN: I was considering everything under 83A, which is not quite true; is it? Anyway, I am talking about the principle.

MR. STEWART: Is what the Chairman has suggested at all similar to what you have in mind on Page VII - 1 when you talk about bonuses to successful exploratory ventures? I notice at the bottom of the page you did rule out tax-free rewards for successful exploration.

MR. PEARCE: Yes, that is right. On the ones we considered on that basis we felt they would be difficult to interpret and administer relative to the gross depletion allowance.

MR. STEWART: Was your thought, Mr. Chairman, there should be some kind of measure to

reward exploration as such whether it was successful or not?

THE CHAIRMAN: Yes, I thought probably all expenditures should be deducted of double the amount incurred or 150 per cent of the amount incurred, or
2 whatever is suitable to equate to what is now done, whatever is suitable to provide sufficient incentives.

MR. LARSEN: I think I can understand what you are suggesting. If we were to take one dollar of the $1.67 per barrel and spend it on 83A type expenditures at 150 per cent allowance you would in effect arrive at a 50 per cent benefit, which is equivalent to the 25 per cent gross benefit.

THE CHAIRMAN: I am not sure it is equivalent.

MR. LARSEN: If you take the $1.00 a barrel you get a $1.50 credit. There is an extra .50 cents realized. I think that is the proposal.

THE CHAIRMAN: My proposal is absolutely anomalous to the research incentive which is in the Act. I am not proposing it be related to any base area. I simply suggest it be in the nature of an investment allowance as is used sometimes for fixed assets. Take 83A expenses and multiply 150 or 200.

MR. LARSEN: This is incentive to spend rather than produce in a way.

THE CHAIRMAN: I am following the answer previously given to Mr. Stewart's question. I think I would reply in the affirmative to what you say. I don't expect an answer to this at the moment if you

have not considered it. I thought you might have considered it. You can't give me anything very profound if you have not considered it.

MR. BUCHANAN: I think our position on this is really to endeavour to go to what we considered the simplest route of taking care of this incentive that we feel is required from a straight administrative standpoint. On both sides of the fence we felt this was by far the simplest thing. There were no problems whatever as far as interpretation of the legislation which, as you are aware from our discussions here, is quite a problem to us.

THE CHAIRMAN: I cannot see the rationale for the 25 per cent. You have not explained it so far. I can understand why you would reduce the rate of tax by one-third, which is what the present system is, I believe, although it is related to income. I think that is pretty well supported in what you have to say. You say in order to encourage people to explore this industry cannot be taxed the same as anybody else. Some of the burden must be placed on other taxpayers.

I think perhaps there may be a reason for that but you say one-third of the burden has to be lightened to make people operate. I cannot see why you should be relieved of paying tax on 25 per cent of the gross. That just doesn't seem to come to anything.

MR. BUCHANAN: Our major concern is that the present incentive allowance is not effective. It in theory exists in the Act and in accordance with the

figures we have collected here, certainly as far as independents are concerned, we have received very little benefit under it.

We are concerned with coming up with an effective incentive that will actually be applicable to us.

MR. STEWART: Gentlemen, do I take it you have assumed for the purpose of your submission and this presentation that we are going to go on in Canada exploring for what I think is called conventional oil?

MR. PEARCE: I think we are.

MR. STEWART: You have proceeded on that assumption?

MR. PEARCE: Yes, we have. I would like to suggest, as is indicated in the brief, that it would appear as though the present surplus in produceability in Canada may reach a point, possibly in the late 1960's, where we will need more oil. As we also outline in the brief you must maintain an exploration programme constantly because you are never certain that you are going to find additional reserves.

I think your question relates to the tar sands. I think the tar sands development may not come before we need more reserves from conventional production in order to meet the increased demand.

MR. STEWART: Now, Mr. Pearce, your brief I think is to the effect that the rate of return to the Canadian industry as a whole at the present time

is too low.

MR. PEARCE: Yes.

MR. STEWART: You consider that it is lower than a return of the other extractive industries?

MR. PEARCE: The majority of them based on our tabulation.

MR. STEWART: Do you think the return is lower than the return of industry generally in Canada?

MR. PEARCE: I would say "yes" again based on the categories we examined, based on taxation statistics.

MR. STEWART: I wonder what your comment would be on this: if the return is low both traditionally and at the present time is it arguable that this industry is not as risky an industry as you claim it is. If it were an extremely risky type of operation and the returns are low why would we have had the enormous amount of capital come into the industry as came in in the last 16 years in Canada.

MR. PEARCE: I think one of the reasons that the figure is low is you have to look at the oil industry from the point of view that it is an internation1 commodity and the price is set by world markets and Canada is faced with the disadvantage of higher transportation costs and to a certain extent higher operating costs than other countries.

I think this is reflected in the rate of return.

I think that there are a number of reasons

why money has been invested in the oil industry. One, as I mentioned earlier, is that in order to grow or survive companies must seek additional reserves.

MR. STEWART: You don't think there is anything in this proposition: granted the drilling of a particular well is necessarily at any time a risk the record of the last 16 years in Canada, at any rate, has been such that looking at the operation as a whole, the degree of success which has been attained as a whole, there has not been on balance an undue amount of risk.

MR. PEARCE: I would say there is more risk than there is in other industries.

THE CHAIRMAN: Has anybody told us what the price earnings ratio is? What kind of yield there may be on the common stocks of the members of this group?

MR. STEWART: Mr. Chairman, I think this is somewhat difficult yardstick to use with this group because in many cases they don't report any income at all.

THE CHAIRMAN: They have six that pay dividends and many more that are successful operators. They have about 100 who produce.

MR. STEWART: Mr. Mitchell, would you care to deal with that one?

MR. MITCHELL: First of all, I don't have the specific figure you are looking for. Maybe we can supply that subsequent to this hearing to-day if that is satisfactory. Secondly, I would comment that the typical independent producer is really investing

at a substantial rate and the typical one has a low net income, if not in fact a negative net income.

For the dividend or non-dividend paying companies I don't think we have much of a yardstick to work with.

Perhaps this question is closely related to the line developed by Mr. Stewart a moment or two ago. He came from the low rate of return to the high risk and wondered how the two fit.

I think they fit because the industry is one that has substantial lead time between investment and realization of return. This is quite evident in the Western Canada picture. Last year we had the first year when industry was in the black since 1947. Am I correct in that?

MR. PEARCE: Yes.

MR. MITCHELL: In essence the oil operator has to be the type of person who is very optimistic, long-range optimism. He foresees the day when things are going to get much better. I would say by nature the oil operator is one who believes he will do much better than the man in the building next door.

I think, for example, if you said to an operator in the United States that only one in forty-seven wild cats drilled in 1956 ever returned its cost of drilling and producing where there was some production that he would look at you with amazement and tend to disbelieve it. Yet such a figure is prepared by a reputable organization in the United States.

As I say, Mr. Stewart, the best answer

is the inherent belief that it is the other man who is going to have this misfortune and that your own operation is the one that will succeed.

If this optimism leaves us, as it may tend to do, then indeed there will be quite a difference in the pace in the oil business.

I think when we talk in terms of items such as a depletion allowance presented here to-day in part we are talking in terms of psychological impact on those who make these expenditures.

I hope these comments have been helpful.

MR. STEWART: I think they have, Mr. Mitchell. I take it one of the things you have in mind is as the years go by, while presumably the need for exploration will always exist so long as we are attempting to use conventional oil, as the industry matures the number of companies which are in the taxable position will increase.

You have now proven very substantial reserves in Western Canada. These are going to be produced over a period. You have a backlog now of potential income which you certainly did not have 16 years ago and which has been gradually increasing.

MR. MITCHELL: Yes, sir. We have a backlog of responsibility to investors and we must squarely look our investors in the eye and indicate to them a satisfactory rate of return on their investment. This is a reasonable thing for them to expect and we must deliver it. The alternative is less investment.

THE CHAIRMAN: I have been curious whether there is a time when this industry will perhaps mature and get to the position where incentives are no longer required on this scale where the oil industry has to be let off one-third of the tax burden. Will there ever come a time when you will say "we are in the same position as every other industry in the country. The market is adjusted for the risk now and we can go ahead and need nothing further."

MR. MITCHELL: One of the great needs, as I see it, with this depletion allowance is what I would term a competitive need or a need for a qualitative opportunity for Canadian investors to own Canadian resources. Certainly as long as other investors are in a preferential position within our own country then I would look for a continuance of procedure that would tend to offset that position.

I would refer specifically, of course, to investment funds coming from the United States. Let me hasten to add in the very next breath that in no way whatsoever are we recommending the lessening of such capital inflow. We very much look to a continuance of this and at the same time an increase in the Canadian investment if this could at all be encouraged by some taxation method.

THE CHAIRMAN: So in fact as long as there is the particular tax treatment that we know of in the United States the Canadian investors should invest in Canada and should not be in a worse position?

MR. MITCHELL: Yes, sir.

MR. STEWART: Mr. Mitchell, do you happen to know whether in the earlier days of the American industry there was a position somewhat similar to the present Canadian position where in fact very little tax was being paid? Do you know whether as the years have gone by the American industry, being considerably older than the Canada, this situation has altered materially and the taxation paid by the American industry has materially incrased?

MR. MITCHELL: Let me say that I am a Canadian and not familiar with the American evolution. I would anticipate such evolution should and would occur and the stimulus to the industry would develop new revenues for the company, both in terms of the indirect revenue with which we are all familiar, and the revenue accruing from taxation on the salaries and so on of both the oil industry and the supporting industries and, of course, taxation of the industry itself.

/ND

MR. STEWART: We certainly have not got away in the United States so far from a desire on the part of industry for depletion allowances and other tax preferences.

MR. MITCHELL: Well, all of us are aware that in the end it is the consumer that pays the cost of taxation. If the tax legislation now existing in the United States were to be altered, presumably there would be a lessening of profits momentarily. Ultimately, presumably, it would come back in balance, with the consumer making up the difference.

I think it is quite natural that those that have such an allowance, which appears reasonably from our point of view, should continue to strive to maintain it.

MR. STEWART: I would like to go to a somewhat different point, and I am not sure if I can explain it to you. Can you turn to table V - 6 of this brief? This is the table where you show cash generated to funds employed for particular industries, and if you look in the left-hand column, which relates to the profit companies, and in the right-hand column with relates to profit and loss companies, the return, the ratio for the natural gas industry is quite low compared to that in other industries. Now, if you look at footnote 1 on that page, you find first of all a definition of cash generated as representing the current year profit less taxes declared, plus capital cost allowance, depletion, write-off of mine development and bond and mortgage interest.

Then you find that funds employed include all debt, except for bank loans, accounts payable and tax liabilities, plus common stock and preferred stock and surplus less deficits.

These ratios or percentages, as I understand it, have been taken from Taxation Statistics, 1962, and I now have open before me Pages 116 and 117, which Mr. Pearce I think it was referred to earlier.

I am now going to suggest to you in particular that we try to eliminate from both sides of this equation so far as your industry is concerned, certain items relating to land. Now, according to my information, Item 46 on Page 116, which is entitled "other expenses and adjustments" relates so far as your industry is concerned primarily to royalties.

MR. PEARCE: To which?

MR. STEWART: To royalties. It may be that this is explained elsewhere in this volume, Taxation Statistics, but in any event I would ask you to assume for the moment that that is so, that Item 46 for your industry relates to royalties.

Now, Item 8 on Page 116 relates to land, and I have had this put to me that if we add Item 46 to cash generated -- I see you have as I indicated a number of items at the bottom of that page under cash generated -- if we add that to cash generated item 46 as well, representing royalties, then of course we get a substantially higher figurer there. If we subtract from funds employed, item 8, relating to land, we get a substantially lower figure there. I am

told that the ratio between cash generated and funds employed on that modified basis -- or, rather, cash generated on that modified basis would be 24 per cent of funds employed.

This is a suggestion which has been made to me, and I think the best thing I can do is read it to you.

"This suggests ...." -- that is the result of that adjustment which is to bring the six per cent up to twenty-four per cent by deleting land items from both sides of the equation -- "This suggests that the depletion allowance to oil and gas is dissipated in the form of higher rents to land owners, and does not result in a greater return to industry. Hence depletion, net or gross, does not act as a spur to exploration, but merely inflates the return to land..."

Now, I will stop there for the moment and ask you if you would care to comment on that now, or if this is a little difficult to handle at the moment, if you would care to let us have your comments on it.

MR. BUCHANAN: Mr. Stewart, what is your basic reason for deleting land? I don't know the definition of what is included in land. Is it by any chance mineral rights that we are referring to here?

MR. STEWART: I take it in your industry -- Item 8, which is land, is a very significant asset figure for these particular companies. Profit companies it is ninety-eight million dollars, and the loss companies, it is six hundred and eighty-two million dollars. It

is not far short of 50 per cent of all assets, and it does not include buildings and equipment, and I was therefore inclined to assume that it represented your investment in petroleum properties.

MR. BUCHANAN: If that is what it is, I do not think it is common in the category as it pertains to other industries as such, and certainly not from our standpoint is there any residual value attached to the land in the sense it has been in the past in the oil industry. This is one thing we have been fighting for some time, trying to clarify this use of the word "land" as related to these mineral rights.

Mineral rights that we are obtaining, if we obtain those properties with full production of those reserves, over a period of years there is no residual value attached to those rights as such. Therefore, to us, it is part of our carrying on exploration and development operations, and is part of the funds that are employed in our business.

MR. STEWART: But assuming that it represents your accumulated land acquisition costs -- it is simply suggested that it might be well, as I said, to take out from both sides of this, that is, from cash generated and from funds employed, these items relating to land. The one, royalties, and the other, land acquisition costs. And to take the percentage there to see what the result is, and it is a materially different result. No one would suggest that you should not have incurred land acquisition costs or that you should not be paying royalties, but ---

MR. BUCHANAN: This item 46 is royalties?

MR. STEWART: I have asked you to assume that. I am informed that it is. It is also a substantial amount. It amounts to something like one hundred and forty-five million dollars.

MR. PEARCE: It would appear item 46 would be too high to be royalties, Mr. Stewart. There is no reference to it in the explanations at the front, to the fact that it is royalties.

MR. STEWART: It may be too high, and it may include items other than royalties. If it could be assumed for our present purposes it is basically that, have you any comment at this stage on the suggested conclusion that your depletion allowance is dissipated in the form of higher rents to landowners and does not result in a greater return to industry, and that depletion does not act as a spur to exploration but merely inflates the return to the landowner.

MR. PEARCE: My personal feeling is that there could not be anywhere near that amount in 46, so therefore you are drawing your own conclusion.

MR. STEWART: Suppose we said half of that was royalties, and therefore cash generated was a smaller amount. If we exclude the amount from the funds employed, we would still increase your 6 per cent figure very materially.

MR. PEARCE: Your revenue in that year, your profit companies' gross revenue were only 48.2 million dollars, so I don't see where you could assume that even half of that amount, 24.6, was made up of

royalties.

MR. BUCHANAN: The corresponding figure on that 24.6, when related back to land value, is it not ninety-eight million?

MR. STEWART: Yes.

MR. BUCHANAN: I thought you had referred to six hundred and eighty million?

MR. STEWART: Ninety-eight million is in profit companies, and six hundred and eighty-two million is in loss companies.

MR. BUCHANAN: I'm sorry.

MR. STEWART: Well, what percentage would royalties normally be of gross revenue?

MR. PEARCE: I would feel they would not have been up in that amount of 48.2 million. I assume this is revenue accruing to the producing companies, which would be after deduction of royalties.

MR. STEWART: And the same would apply to the $274 million on the loss companies?

MR. PEARCE: Correct.

MR. STEWART: Probably what fraction of the $48 million or $274 million would royalties be?

MR. PEARCE: It would be I would assume in 1960 about 10 per cent.

MR. BUCHANAN: Between 10 and 11 per cent.

MR. PEARCE: But I don't think it would be included in that amount under expenses.

MR. STEWART: Let me put it to you this way: I am afraid I can't be positive as to the amount

of royalties under Item 46. I was led to believe that the item was largely royalties, but let us assume that we reduce Item 46 quite substantially. There is a total of $135 million there; let us suppose we take $25 million out of the $135 million, which is less than 10 per cent of the $48 million and the $274 million that you have in Item 27. This would still represent a substantial addition to cash generated, and if we --

MR. PEARCE: I don't think I can accept at this point that royalties would be included in Item 46.

MR. STEWART: Well, where do you think they would be included?

MR. PEARCE: I would think they are taken out before you arrive at the gross revenue figure up above of $274 million. I was under the impression that the revenue figure or sales figure as listed in volume 27 is net to the producer after royalties.

MR. STEWART: Let's forget about any adjustment of cash generated. Let's leave it the way it was. If we look at the other side of the equation -- I am not sure we should forget about it altogether because the reason I am putting it to you, whatever has been paid by way of royalties should perhaps go into cash generated. I do not want to give that one up. But let's forget about it. Let's assume your cash generated figure remains the same.

If from funds employed we get a total of the two items in Line 8 which is $780 million, this results in a very substantial difference, and the rate

of return would be increased from 6 per cent, not to 24.18 per cent which is the figure I gave earlier, but let us suppose it is simply increased to 10 per cent which is less than 100 per cent increase.

What would you say to the proposition that I have put that has been suggested to me? I will repeat it again so that it is quite clear what we are talking about. This suggests that the depletion allowance to oil and gas is dissipated in the form of higher rents to landowners, and does not result in a greater return to industry, hence depletion, net or gross, does not act as a spur to exploration, but merely inflates the return to land.

MR. PEARCE: All I think I can say on this point is that mathematically if you make the deduction you suggest in land, that it would increase your cash generated as a per cent, but I do not feel at this point I can accept that your reasoning behind it is correct.

MR. STEWART: I will go on and give you another quotation from what has been put to me by one of the Commission staff. I quote again, "An interesting corollary if the foregoing is accepted" -- you haven't accepted it yet -- "is that depletion allowances are in part a transfer payment from the Federal to the Provincial Treasury. In Alberta the Crown holds approximately 81 per cent of the mineral rights; in Saskatchewan it holds a somewhat lesser proportion ...", and then it goes on and deals with British Columbia and Manitoba, but I do not need to

bother about that.

It seems to me that somewhat the same point is being raised as we were discussing this morning in connection with the further deduction which was accorded last year under Section 83A. You remember we were discussing whether the fact that acquisition costs are now deductible under Section 83A may have had an effect on the amounts which people are prepared to bid on Crown sales. Now, here it is suggested that the effect of depletion, depletion allowance, may be somewhat similar. In other words, the landowner is a substantial beneficiary of the tax preferences which exist so far as your industry is concerned in Canada at the present time.

MR. MITCHELL: Mr. Stewart, if I might comment on that one. There are probably three reasons why that comment might be reconsidered. First of all, the increase in prices paid to landowners in Alberta is, as was indicated earlier to-day, by no means established. One might assume that they would be on the upward trend, and that there may be some who would analyse any given set of bids and reach such conclusions. To my mind the very other variables involved would have far greater impact than this tax consideration.

Secondly,if one is talking in terms of allocation of revenue between Federal and Provincial Governments, there are substantial blocks of mineral rights now owned by the Federal Government and which have prospective value for exploration, so that there might be a self-adjusting factor already in progress

in normal exploration activity in this country.

Thirdly, and this I understand developed while I was away unfortunately last week, but I hear tell that there is some idea in motion to perhaps re-allocate these revenues to take into consideration mineral resources revenue as between Federal and Provincial Governments. I have no personal knowledge of this, but I did hear some newspaper report to that effect.

These things I think are importantly in the background when considering the points that you mention.

COMMISSIONER PERRY: I think this has been a pretty good discussion but it has not been going quite deep enough. One might even suggest that if it were not for the fairly liberal, and I use the word in its most impartial sense, treatment of the oil industry under the Federal laws, that Alberta may not have been able to institute this system of optioning at all. If there was a lower tax flow then this industry option process might have been applied, and your land costs might have been half of what they were to-day. You have to go this far I think to really consider the point that is being made.

MR. MITCHELL: Well, certainly any substantial change in tax treatment of any industry will have its impact, and if there were substantially different tax procedures in existence for the oil industry, the oil industry in Alberta would be in a different position, I quite agree.

COMMISSIONER PERRY: The inference that is being drawn from the point that Mr. Stewart is making is that a further substantially different treatment may simply aggravate the result that the existing treatment has produced. In other words, the fairly high cost of land, assuming that the existing treatment has produced this result.

MR. MITCHELL: I can only from my point repeat the arguments already presented, sir. This involves land held both Federally and Provincially ultimately and in fact to-day. I do not feel that this Association can place itself in the middle of, you might say, allocation problems between the two Governments.

COMMISSIONER PERRY: No, I do not think this is anything more than an interesting line of speculation. I think it does reveal the extent to which your net return is very likely reduced by the very large element that land plays in your funds employed. You need not go beyond that.

MR. MITCHELL: You can hope the day will arrive when there will be substantial payments to the Federal Treasury as well.

THE CHAIRMAN: Are you leaving depletion allowances, Mr. Stewart?

MR. STEWART: I am about to deal, Mr. Chairman, with some American arguments which have been made against the depletion allowance in the United States. In that sense I am leaving depletion in Canada.

THE CHAIRMAN: Before you leave depletion

in Canada, the point is made somewhere in here, and I cannot quite find it now that if we reverted to depletion based on gross it would place independents in a far different position with the integrated companies than they are now. Integrated companies now get some benefit by virtue of depletion on net.

If depletion were computed having regard to the taxable income, that I would think would be the case, but as you pointed out this morning, it is computed having regard to production income. I would have thought production income is the same for an independent as an integrated company; is that not true?

MR. LARSEN: If I may answer, sir, I believe one of the basic differences is, let us say, the integrated oil company has a profit now and was always able to immediately use Section 83A deductions against any income of the company over the years. Therefore they have never been in a position to have the carry-forwards that influence our ability to take depletion.

MR. STEWART: The problem is that in determining production income at the moment under the regulations you must deduct all your Section 83A expense so that you do not have any production income to deplete until you have had sufficient income to blot up all your Section 83A expenditure.

THE CHAIRMAN: Is that not equally true of integrated companies?

MR. STEWART: I take it that what these gentlemen would say -- certainly what has been said

in print -- is that an integrated company can utilize its refining and marketing income to blot up its Section 83A expense. Is that not the reasoning?

MR. LARSEN: I think historically the average independent company started with no production. They had several years of exploration, and in many cases he achieved the same production, but he has that carry-forward of costs through those years when he had no production at all, and in many cases he still has.

Now, going back to the company that was already a profit-making company at that time, he was absorbing those what you might call, to use the term "pre-production costs" against income from other sources so he doesn't have a backlog to be recovered before he can take depletion.

THE CHAIRMAN: I suppose a happy way to do it would be to restrict reduction of 83A expenses --

MR. STEWART: No witness has yet proposed that.

MR. LARSEN: This is one thing that passed me by when we were discussing this Imperial Oil depletion. This is part of the answer I would like to pick up on that point.

MR. STEWART: Do you want to enlarge on that point now? I put it to Imperial Oil when they were being examined here what would the effect of their proposal be on the company which had a large accumulation of Section 83A expense. The answer, if I remember correctly, was simply that it would certainly not adversely affect them. They would continue to work off

that expense.

MR. LARSEN: They would continue to work it off without effective percentage depletion, since we have not had other income to dispose of our earlier exploration costs.

MR. STEWART: Your whole submission, gentlemen, it seems to me as regards depletion is based on the proposition that we referred to earlier that your industry or your part of the industry does need this type of depletion allowance as an incentive.

I am very conscious of the fact that in the United States at the present time, and I think for some years, there has been a great deal of criticism of depletion allowances for the extractive industries as a whole, not just petroleum industries, and I would like to refer briefly now to the basis of the attack which has been made in the United States on this depletion allowance, and ask you to indicate whether or not that basis of attack is relevent in Canada.

Now, I am going to telescope this to some extent, but part of the reason is this: in your industry the after-tax return at the present time is no better than normal, and this appears to be the case in Canada, and you have been inclined to say to us that the return is less than normal. Assuming that it was an average rate of return after tax, then as your industry is entitled to a depletion allowance, your pre-tax return must be lower than the average. That means that this particular tax preference - and this depletion

allowance is certainly a tax preference - is being granted to an industry whose pre-tax returns are abnormally low, and the question has been raised in the United States whether this is appropriate, or whether to grant tax concessions to an industry of this sort does not involve -- and these are their words, not mine -- a misallocation of the resources of the country. What would you say as to that?

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MR. MITCHELL: Mr. Stewart, the usefulness and scope of the oil and gas industry in Canada, like that of the United States, is fairly well known to us all. Perhaps it is so well known that we tend at times to set aside the obvious and get on with the problem at hand.

The oil and gas industry is the energy business. I think it is a fact that most of us will accept that a country with abundant energy is a country that has a rising standard of living for its people.

If "misallocation of resources" in the United States is the term applied to the producer which has built a mighty oil industry of tremendous economic worth to that country, of tremendous importance to its employment and to its security, if "misallocation" is the proper word to use there I am happy to apply the same to the similar operation in Canada.

I suggest it is not the right word. They are doing what is entirely reasonable and proper in the circumstances. They are encouraging a high rising industry to have a firm foundation and lead the economy of that country, through utilization of energy resources, to a very, very high standard of living. I suggest that standard is indeed very closely related to the energy supplied by oil and gas.

MR. STEWART: I think that is a very strong statement Mr. Mitchell, if I may say so.

COMMISSIONER PERRY: I would like to ask the representative of the industry how far you push this sort of thing? Would it be good for Canada if

everyone were employed in the oil industry and this were a very successful industry and we were enjoying a very high standard of living. Is there not some point where you stop, even with a good thing? Is it not to the advantage of all to have a well balanced economy and a variety of things going on?

THE CHAIRMAN: What was going through my mind was that tomorrow we are going to hear from The Canadian Welfare Council. They will point out that welfare measures in Canada provide a great deal for a higher standard of living than we would have if they did not have welfare measures. They are dependent upon taxes.

MR. MITCHELL: Let me say immediately to both you gentlemen and the Commission I do not envy you your task in allocating the resources of the country among the very many great needs of the country.

Our position here is to talk about the oil and gas industry. Perhaps by proximity and private participation we are indeed more greatly enamored with its importance than we should be. I don't believe so at heart. I honestly believe, and I suggest anyone can examine it who cares to, that the energy resources of our country are certainly closely allied to the standard of living.

Now I would agree that all good things have to come to an end. I think that is an expression in fact somewhere. The Canadian industry I hope has not come to the end. I hope it has quite a way to go yet. It is saving this country a considerable amount

now in exchange.

I will avoid the temptation to get into this brief again. I think this brief certainly covered it quite adequately. We have been doing a lot for the country and it should do more. We think it can take up $150 million in balance of payments without any great difficulty. There are those who say we have energy running out of our ears, to use the expression, because of the Athabaska Tar Sands. This is not true.

We have reserve of probably 350 billion barrels. We are using 10 billion barrels a year. We have quite a few year's supply but there is still considerable pressure on Canada and on the world.

We look to the day that Canadian crude will not only supply Canada but will be an important revenue generator for this country because of export importance, particularly across the line.

I hope without too much of a monologue, sir, I have answered the question. I would be glad to answer more fully if I may.

THE CHAIRMAN: I couldn't disagree with a word you said. Our only problem is that every industry that comes before us feels just as confident of its role in the economy as you do; just as confident the tax system should be used to give them assistance in the national interest. There is no doubt of anyone's sincerely on it.

MR. MITCHELL: I imagine they all are quite sincere. I am perhaps trying to underline a point. It is more than just sincerity in the case of

the oil and gas industry. I suggest all of us might reflect on the value of energy to this economy.

COMMISSIONER PERRY: Having heard the representatives of electrical energy yesterday they are just as firm as you are.

MR. MITHCELL: We would like to see them encouraged too.

MR. MITCHELL: I can appreciate that too.

MR. STEWART: Gentlemen, there are a good many points which have been made in this argument that is going on in the United States against the depletion allowance. I don't think I will attempt to catalogue them but I might refer to you, for what it is worth, a publication which I have mentioned on other occasions when I have been examining representatives of your industry. It is called the Federal Revenue System Facts and Problems 1961. It was prepared for the use of the joint Economic Committee, Congress of the United States. It was published by the United States Government Printing Office in Washington in 1961. There is a chapter on taxation of income from natural resources which commences at page 89 and goes on to page 101 which deals with that particular subject and which sets out the pros and cons of depletion allowances and other features of the American system of taxing the extractive industries.

If you should have occasion to look at

that and comment on its pertinence or lack of pertinence to the Canadian scene I think it would be helpful to the Commission.

Rather than go through all the arguments which are made there I think I might mention that towards the end of that they deal with certain proposals for tax reductions and in substance I think these are some of the points they raise: first of all, that the deductions which the industry should be permitted to make should be confined to the amount of its expenditures with provision for fairly rapid write-off.

They also suggest that the rate of percentage depletion should be reduced in the case of your industry from 27 ½ % to, I think, 15%.

They suggest the present 50 per cent net income limitation should be reduced perhaps to 25 per cent or 30 per cent.

They suggest, I think quite seriously, that these tax preferences should be eliminated altogether and replaced by some form of subsidy so that it would be possible for the country to know exactly what assistance was being given to these extractive industries.

Now this is a document which is before us on this Commission and it is in the face of that that you come and suggest not only is the present system we have in Canada inadequate but so far as depletion is concerned the basis should be changed very much to the advantage of the industry.

Now I don't suppose really there is much

more to be said on this. You have set out in your submission why you think that a higher allowance is required. However, in the light of what little I have just said you would like to enlarge on the situation I hope you will do so.

MR. LARSEN: The only statement I have to make there would have to be in general terms. As long as I have been associated with the oil industry there has been a continuous attack on the U.S. depletion rate by certain segments in the United States. It has come up for review on the Congress numerous times. The net result has still been no change. This may be a more serious attack on it but this has always been an attack and the 15 per cent rate has been mentioned before as a possible rate. Now I only say that this is no particular indication that there will be a rate change in the United States any more than there has been in the last ten years or more.

MR. STEWART: I have seen it suggested that the change in regime in the United States which has just occurred may not have an adverse affect on the petroleum industry in this regard.

MR. LARSEN: I think it would go without saying.

MR. MITCHELL: The fact it has withstood so many assaults is indicative of its usefulness.

MR. STEWART: I think that is a suggestion worth considering.

MR. LARSEN: This has been, I suppose, broadly our reasons. We feel the necessity for more

effective depletion in the States because we are selling barrels of oil in direct competition with the persons producing on the 27½ per cent rate.

MR. STEWART: Yes, I think this is a useful point. The Canadian industry is exporting substantial quantities and must export in a market governed by different rules.

MR. LARSEN: And we must meet their price in effect.

MR. STEWART: Now one of the points you have come back to from time to time in your brief is that you consider the present system works out to the advantage of the integrated company at the expense of the non-integrated company.

I think that we have probably covered most of the material considerations there are in our talk to-day. Perhaps I could just mention what I think may be the material points and you can let me know whether I have stated them correctly.

First of all, the integrated company can set off its section 83A expense against both production income and other income with the result that it can claim depletions earlier and may not lose as much depletion for the tax purposes as the independent company may do.

Secondly, if it arranges its affairs accordingly the integrated company may be able to set off its Section 83A expenses largely against non-production income.

Which means that it gets the credit

against income which would otherwise be subject to a high rate of tax, and not against production income, which would be taxed on the 33-1/3 per cent.

Thirdly, the large majority of the independent companies have never been able to take depletion for tax purposes to date.

Then I had as a fourth point the question whether Section 83A expense should be allowed only against production income.

Leaving aside the fourth point for the moment are my first three the basic points that you have in mind in this connection?

MR. BUCHANAN: I would agree with it, not necessarily in the order you list them.

MR. STEWART: The fourth point raised a few minutes ago by the Chairman, what do you say on this proposition that Section 83A expense should be deductible only from production income?

THE CHAIRMAN: I might say that that thought came to me a little quickly. I had not considered it at all fully. It makes good sense though.

MR. MITCHELL: Generally, Mr. Stewart, we would favour equal treatment for all and no removal of the position which the integrated company now has.

MR. STEWART: I heard the first part but not the second. You favour equal treatment for all?

MR. MITCHELL: And certainly no removal of the position that the integrated company now has.

MR. LARSEN: Other parts of our brief

have even suggested the availability of this deduction against other types of income than that now allowed to be reduced by 83A credits.

MR. STEWART: In other words, you have suggested in this a company whose principal business is not in the petroleum field should be allowed to engage in exploration, et cetera, and apply that expense against income from all sources.

Now one of the exercises is to induce Canadians to invest in the Canadian industry. I have one or two points I would like to put to you on that particular point. This was a point that was also raised in your other brief, I think.

Now it has been suggested, I think in the United States, to permit the ordinary individual to deduct exploration and drilling expenditures from other income is likely to lead to unwise expenditure of funds. What is your feeling in that regard?

MR. PEARCE: I would submit that we are interested in increasing the participation of Canadians in Canadian industry. We have indicated that there is going to be an increasing need for further reserves of crude oil and natural gas and therefore if the tax laws were such that other industries could deduct from taxable income their cost on oil ventures it probably would result in their joining forces with oil operators. In view of the fact that we are going to require additional reserves I don't think it would be a misallocation of capital or misuse of capital.

MR. HOTCHKISS: I think any potential

investor is going to look pretty hard who he is putting his money with. If you are getting into the area of squandering money I don't think it would be a serious problem. In the oil business it is a little hard to define what is waste. We drive lots of dry holes but all of them have contributed really to the progress of the industry. I don't personally feel that would be a real problem.

MR. LARSEN: Insofar as I have ever had any relation to it the individual money in the States, or the non-oil money is in almost all cases going into the oil industry through established companies. Very often they are consultants who are experienced oil men. Now there may be some which have gone by other routes, but this is basically the method it has come to the industry.

MR. STEWART: Now the Canadian private investor is apparently going to have a good many outlets for his funds in the next few years. We are led to believe that he is going to be asked to acquire 25 per cent in a great many Canadian companies. We are told in order to acquire that 25 per cent interest in existing companies alone he is going to have to find some two thousand to three thousand million dollars.

Now if this change that you suggest is made in our depletion allowance would you really be optomistic that you could obtain from Canadian sources any real substantial portion of the capital which your particular industry is going to need in the next few years.

MR. HOTCHKISS: It is a very difficult thing to estimate. Not having any incentive to this point to seek out those funds, I don't see really how you could judge that.

MR. STEWART: You feel at the moment, I take it, the likelihood of attracting a substantial investment from this particular type of Canadian investor is not very great, perhaps, but that it would be materially inmportant?

MR. HOTCHKISS: I think it would be materially important, and I think perhaps there would be a real opportunity there. We are not looking at the individual investor; we are also looking at companies other than oil companies. Perhaps they are far more important.

MR. STEWART: You are thinking essentially of liquid investment?

MR. HOTCHKISS: No, direct investment. That would be among them.

COMMISSIONER PERRY: Perhaps it might help us all if we could hear a thumbnail sketch of the provisions. I have a vague idea what they are, but I am getting a bit rusty on the subject.

MR. LARSEN: I think probably the key ones are relatively simple. The main one is that a U.S. taxpayer, corporate or otherwise, can deduct what we call drilling expenses here in Canada from taxable income from any source in determining his income tax paid.

COMMISSIONER PERRY: Does he have to be in the position of a partner in a drilling venture or what

is the vehicle?

MR. LARSEN: He has to have a proprietary interest.

MR. HOTCHKISS: In the asset that he is developing. He has what we call a working interest in order to deduct whatever is his percentage of the cost.

MR. LARSEN: He doesn't have to do it in the form of a partnership. He can do it directly as an individual.

COMMISSIONER PERRY: But through an agreement of a specific kind with a corporation?

MR. HOTCHKISS: Or he can do it on his own. He can go and drill his well absolutely on his own. Most of them, through lack of experience in this business, chose to do it through someone more experienced.

COMMISSIONER PERRY: I was thinking of an industry where you have an established group of companies, and you are looking for new money at this time. It would be through a form of contract between an individual and a corporation which would give some sort of proprietary right in the oil that is found.

MR. HOTCHKISS: It is an advantage usually to the investor company. In addition to broadening their participation, there is usually some further leverage involved in handling the funds.

COMMISSIONER PERRY: What is the limit? I have some vague recollection of an amount of $100,000.00 that was involved in one of these.

MR. HOTCHKISS: It is my experience it is without limit.

THE CHAIRMAN: Lifetime total of $400,000.00.

COMMISSIONER PERRY: Does this mean anything to any of you?

MR. HOTCHKISS: I am quite sure that is not correct.

THE CHAIRMAN: I think it may be mining rather than oil.

COMMISSIONER PERRY: There must be something in it if we both heard it.

MR. PEARCE: If I might comment further on an earlier question in connection with our field work associated with this study, we talked to a number of oil people out west, and they all indicated to us that as a result of their own investigation for funds, that they have indications that there is considerable interest in Canada on the part of individuals and other companies to invest in the oil industry if they had the opportunity.

MR. STEWART: Thank you very much.

COMMISSIONER PERRY: Just one further question. Under our system what rate of depletion would this particular form of income fall? Americans don't have the double rate. Would it be the corporate depletion rate or shareholder depletion rate that would apply in Canada?

MR. HOTCHKISS: I think under the new Act it would be the corporate rate, 33-1/3 per cent of the net profits from oilincome.

MR. BUCHANAN: If he were directly participating. If he were just a royalty holder then he would be classed as such and subject to 25 per cent.

MR. HOTCHKISS: I think with the change in 1962 it was intended to give a more favourable atmosphere for Canadian investors of this type. Before that of course you couldn't combine your income and expenses as capital loss.

Unfortunately with this restriction they can't use their costs. I feel it has more than taken away the advantage that was given. I don't think you are going to get people to put money in the oil business and take it out as ordinary income without being able to use your costs.

THE CHAIRMAN: The man who is going to participate, who would draw a contract with the company and it would be agreed that he would put into the company in some form other than stock I would assume, because he is not going to be taking down shares, if he puts certain monies up to be spent on drilling or exploration, at such time as they were spent I would guess he would get some kind of certificate of certificate or report he could use on his tax return.

If there was success the contract would provide he would get a certain share of the results from this particular operation. Is that it?

MR. HOTCHKISS: Yes, sir. It could take several forms. For example, he could go into it venture by venture. He could go in and join with a number of companies, or he might more likely have an arrangement

with a company that he had knowledge of to perhaps participate to a certain extent in everything that that company did.

MR. LARSEN: In which case maybe participating as a member of a joint venture, which I think is a common form.

MR. HOTCHKISS: Yes.

MR. LARSEN: Possibly the company being one of the ventures..

MR. HOTCHKISS: In Canada this has been common to see it through partnerships, associations, or syndicates, to come under Section 83A. That is still very common.

COMMISSIONER PERRY: The arrangement between two corporations would be the same excepting you substitute the corporation for the individual?

MR. HOTCHKISS: Exactly.

MR. STEWART: On your depletion system, the one that you propose, suppose a particular company ends up with a loss; suppose it is entitled in a particular year to $500,000.00 on depletion, but its income before that depletion is taken into account is, say, $400,000.00. I am not certain whether it is mathematically possibly or not, but if it is, then you have got in effect $100,000.00 of depletion allowance which you have not been able to utilize in that year.

I do not think you deal in your submission with the question of whether or not that $100,000.00 of unutilized depletion could be carried forward to another year. Is this a part of your proposal?

MR. BUCHANAN: Yes, I believe that is correct, Mr. Stewart. We were looking at this incentive allowance in effect being earned from the standpoint that in applying it -- the calculation of it against gross income, he has got to have gross income in the first place to be entitled to any of that depletion allowance.

If he is thrown into a tax loss position, I presume it is because of exploration costs, development costs that he has incurred.

When you say a tax loss position, I assume you are referring to after application of 83A expense?

MR. STEWART: 83A expenses are deductible only to the extent that there is income.

MR. BUCHANAN: Are you going beyond that into a true loss position and therefore limited to your five-year carry-forward?

MR. STEWART: I haven't really carried this through. I wondered if you expect to use depletion to create a loss which could be carried forward.

MR. BUCHANAN: I don't believe it occurs necessarily.

COMMISSIONER PERRY: Would it not on a gross basis?

MR. BUCHANAN: Not a true tax loss. It certainly could as far as application of 83A expenses are concerned.

MR. STEWART: Supposing we have a company that has, under Section 83A, carried forward

its production, and therefore it becomes entitled to 25 per cent gross depletion. On the operation as a whole it has a loss. Do you suggest that the depletion allowance can increase the loss which can be carried forward, or produce a loss which can be carried forward?

MR. BUCHANAN: Certainly if that were to occur, you are dealing with the exception I would think. I must say I don't think we have given consideration to that type of thing.

MR. STEWART: Mr. Chairman, I think that is all I would like to ask.

THE CHAIRMAN: Thank you, Mr. Stewart. I do not think we have any questions. This has been a very interesting day for us. You have taught us, and I speak for myself, a good deal about your industry, and I am delighted to learn more about your industry.

I am pleased that Mr. Stewart goaded Mr. Mitchell into a declaration as to the value of his industry. I might say we share his convictions.

I have no hesitation in saying we all recognize the great work of the oil industry and the fact that energy does contribute to our living standards, and has certainly greatly improved our balance.

This has all been a very excellent day indeed. I can assure you that we will continue to ponder this. As you will understand, it is our job to try to decide first of all how the burden of taxation shall be spread over Canadian citizens, through

their business, and all kinds of ways, so as to do the least damage. That is all one can say. The most we can do for anybody is to recommend that there be no tax imposed. We can't recommend anything which will by itself turn night into day, but there are going to be areas where we must recommend that the burden of taxation should be lightened and should be passed on to others, and we certainly propose to face up to that.

We thank you very much for your attendance here to-day. It has been a great help to us. You have certainly improved our knowledge of this very important area.

MR. MITCHELL: Mr. Chairman, I wonder if I might make a concluding statement very briefly to the Commission?

THE CHAIRMAN: By all means.

MR. MITCHELL: My position here to-day is certainly not one of a tax expert. Rather, as a businessman who represents a group of other oil businessmen, and there are two or three things that came out during the course of discussions which I should appreciate a brief moment or two to comment on.

It is not an attempt to review the prime feature of depletion or other aspects of the submission. This is not to detract from them in any way. We are looking hopefully for the quality of opportunity as businessmen between Canadian investors and non-Canadian investors.

We have neither asked for nor have we

received tariff protection. We hope in the discussion to-day points have been brought out that there is in the oil business a need for substantial leave time between the investment and the realization of that investment far greater than is customary for many other investments.

We have attempted also to bring out by virtue of Mr. Stewart's goading the importance and the impact of this industry on Canada.

We look hopefully for clarification of uncertainties that now exist from a businessman's point of view, which very seriously retard our policy to carry out business. Many of these are indicated in the supplemental submission, and we hope before too long there will be clarifications that permit us to proceed with reasonable assurance as to the tax laws of the land. We do not have that feeling at the moment.

We hope, too, that any tax changes would permit us economies in operation such as, for example, consolidation of non-arms-length companies. Finally, and perhaps this is more my personal view than an association one, although I suspect the two are the same, we look forward to the freeing of as many of these keen minds in Canada that have dedicated their full time and energy to working around the tax laws; to free those minds to things that will be of much greater productive importance to Canada. We need these people. It seems to me there is a growing tendency for the need to increase and increase, and it is always

the best brains who are at work.

Finally, sir, and to members of your Commission, it is a very great pleasure to have this opportunity to appear before you. Very sincerely we appreciate it, and we appreciate seeing first-hand democracy in action as it is here. I thank you on behalf of our association and all our representatives.

THE CHAIRMAN: Thank you, Mr. Mitchell, and gentlemen.

MR. STEWART: I think Mr. Vance and possibly other members of our staff would like to see if we could obtain on loan or otherwise some of the working papers that have been mentioned here to-day. I take it they can approach you or Mr. Buchanan or Mr. Pearce?

MR. MITCHELL: We would be very pleased to co-operate in any manner whatsoever.

MR. STEWART: Thank you.

THE CHAIRMAN: We stand over until 9:30 tomorrow morning.

ROYAL COMMISSION

ON

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THE ROYAL COMMISSION ON TAXATION

Hearing held in the Centre Court Room, Exchequer Court of Canada, Supreme Court Building, Wellington Street, Ottawa, on Friday, the 6th day of December, 1963.

C O M M I S S I O N

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SECRETARY

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---Upon Resuming at 9:30 A.M.

THE CHAIRMAN: Mr. Secretary, I think we can commence.

THE SECRETARY: Thank you, Mr. Chairman, Commissioners. This morning the first brief is being presented by the Canadian Museums Association. Dr. A. D. Tushingham, who is head of the Arts and Archaeology Divison of the Ontario Museum, President of the Association, is here this morning with his colleagues. He will speak to the brief.

Associated with Dr. Tushingham is Mr. W. J. Withrow, Director of the Art Gallery, Grange Park, Toronto, who is Chairman of the Taxation Committee of the Association, and Mr. Peter Watt, C.A., Tax Advisor, and Mr. Marvin Gelber, M.P.

Mr. Chairman, I would like to enter this brief into the record as Exhibit 280.

---EXHIBIT NO. 280: Brief presented by Canadian Museums Association.

SUBMISSION OF

CANADIAN MUSEUMS ASSOCIATION

Appearances: DR. A. D. TUSHINGHAM
MR. W. J. WITHROW
MR. PETER WATT, C.A.
MR. MARVIN GELBER, M.P.

THE CHAIRMAN: Thank you, Mr. Secretary. Good morning, Dr. Tushingham, and gentlemen. I am very pleased to see my member here. I am flattered and surprised. Greetings. Dr. Tushingham, we have read your

submission with a great deal of interest, I might say, and we will have questions to put to you concerning it. As you probably know, this problem does not come to us anew. We have heard from the Art Gallery Association - I think that is the correct name.

DR. TUSHINGHAM: Canadian Conference of the Arts.

THE CHAIRMAN: Yes, it was the Canadian Conference of the Arts. They raised the issue which you have carried further in your submission, and it may be very helpful to us. Before we come to grips with it, have you anything you would like to put before us? You do not need to read the submission now as we have already read it. Do not bother standing, unless you wish to do so.

DR. TUSHINGHAM: I would like to make a brief statement. Mr. Chairman, and members of the Commission, I would like to point out first that the Canadian Museums Association was incorporated in 1947 for the purposes set forth in Item 1 of our brief. These purposes can be summarized by saying that the Association exists to promote the well-being of Canada's museums as important contributors to Canada's cultural and intellectual life.

We have two classes of membership, individual and institutional. Our institutional members and our officers are appendix A in the brief. Both individual and institutional members share the same rights and privileges, voting and other privileges within the organization.

We have also attached as appendix B a defininition of a museum which we hope, at our next annual meeting, will become one of our by-laws to replace the present definition of museum which is somewhat a rule of thumb.

I, as President of the Association since last June, have appointed various committees to study certain problems, one of which is the Tax Committee of which Mr. Withrow is Chairman. The other two members are Dr. V. B. Meen, the Head of the Earth Sciences Division of the Royal Ontario Museum, and Dr. Evan Turner, Director of the Montreal Museum of Fine Arts.

As Mr. Bennett has pointed out, we have Mr. Watt with us to counsel us as necessary. With your permission, sir, I would like to ask Mr. Withrow to present the brief on behalf of the Association or answer questions you may wish to put to him.

THE CHAIRMAN: Thank you indeed. Mr. Withrow, do you have anything to say before we proceed with the questions?

MR. WITHROW: I would like to say our brief is made briefer by the work of theCanadian Conference of the Arts to which you referred, so we will skip the preamble that might have been necessary.

I would like to remind the Commission that Canada is rather unique in the situation regarding museum support. One thinks of the Federal systems of wide scope in the U.K., France and Italy, and we are much more like our colleagues to the south. We depend on support from the community. Unlike our American

colleagues who have certain advantages, tax restrictions which potential donors to Canadian museums face, I think might be changed. The Canadian Museum Association therefore is concerned with several problems related to both charitable donations and bequests to museums.

We would like to emphasize the importance of making some changes so that, first of all, important collections, private collections now in Canada will not be lost to this country but will go to museums donated by private individuals to museums of their choice.

Secondly, that Canadians may find it more attractive to give generously to Canadian museums, and thus, like their American counterparts, relieve the Government of responsibility which we feel would be very costly indeed, and which, without the activity of the private patron, the Government would surely have to shoulder.

Our brief, as you know, contains four recommendations only; three about income tax, and one about estate tax. I need not take up your time to even summarize this as it has been done in the brief. I would like to add one which we did consider and was not written in it, and at the same time I apologize for certain typographical errors in the brief because it was created in a hurry in order to meet the deadline. I was overseas at the time, and had one day to get it mimeographed. I apologize for that.

The one thing that we might have added, and I think it was touched on by the Canadian Conference of the Arts Brief, the possibility that the present 1- year

restriction on deductions be relaxed to permit spread of tax relief over several years. Perhaps we could discuss this as we get into the brief. I feel we are open for questions now.

THE CHAIRMAN: Thank you indeed. We have section 27 (1) (a) which would seem to take care of gifts to recognized charitable institutions. I think you indicate that the law may well be good enough to take care of gifts in kind, but that it is not clear. Am I correct in that?

MR. WITHROW: You are correct, sir.

COMMISSIONER WALLS: I wonder if I could have a picture drawn as to the extent that museums are reliant on endowments such as libraries are under the Canadian Foundation?

MR. WITHROW: The situation varies greatly across the country, and I can only speak really for those Art Museums that I know. We have no maintenance endowments whatsoever in Toronto. Each year we have to raise roughly 50 per cent of our operating budget. Our collection has been given to us completely from private sources either as gifts in kind or money to buy. I think this is very common. In places the percentages are a little more or less, but those maintenance and purchase funds have to be raised as they go along.

THE CHAIRMAN: And you obtain Government support; am I not right?

MR. WITHROW: Yes, we do. The other 50 per cent of our operating budget comes from the Government

at three different levels in our case, but this does not look after our collection.

COMMISSIONER PERRY: One other related question, and that is whether your museums as a group have any difficulty in obtaining certification as charitable organizations.

MR. WITHROW: May I ask the President to answer that one?

DR. TUSHINGHAM: I know of no case where this has happened, where there has been difficulty, except in the law in Ontario which provides I think now $600.00 to those municipalities which have local museums towards the salary of a curator.

This can be given only where the museum is a municipal museum, and many of the smaller local museums began as an activity, say, of a Womens' Institute, something of this kind, and these have often been not too willing to give up control in order to get the $600.00. They feel once the town or village takes over the museum, those who are interested, those who have kept the museum going for a generation or two, will be out, and the museum will die. This has been a problem, but as long as they are prepared to accept municipal status, they can get this grant.

COMMISSIONER PERRY: This would be no handicap for income tax purposes. It might in fact be an advantage I suppose. I am sorry I did not make my question quite as clear as I should have. I was thinking only of eligibility as a charitable institution under the Income Tax Act. Are your museums as a group

recognized without question for this purpose?

DR. TUSHINGHAM: Yes, we are.

COMMISSIONER PERRY: There is no problem on that side then?

DR. TUSHINGHAM: No.

THE CHAIRMAN: I am going to pursue that one step further. There are one or two listed here that I would be curious as to whether or not they would be eligible. I see the Hiram Walker Historical Museum; the Glenbow Foundation. I have an idea that those are collections more or less developed by an individual or company, and they may or may not be shown publicly. I don't know whether they are.

DR. TUSHINGHAM: Yes, they are shown publicly. I can answer for the Glenbow quite clearly. The Glenbow receives its money from the Harvey Foundation, which is a family foundation of Eric Harvey and his wife and children. As a foundation, presumably it is not taxable, but the collections which are purchased with this money are public collections and on view in several museums, one in Banff, one in Calgary -- two in Calgary -- or as travelling exhibits going out to some of the smaller museums around the province.

In this case, with one museum at least in Calgary now, the Province of Alberta is providing maintenance for the building and staff salaries, while the Glenbow Foundation provides the material, the objects which go into the production, and expertise.

THE CHAIRMAN: It would qualify as a charitable organization?

DR. TUSHINGHAM: Yes, I think so.

COMMISSIONER MILNE: In looking at the list, I was wondering about this, but I do not imagine it is too important whether I know definitely: the Arts and Crafts Museum in Saskatchewan is a Ukrainian Womens' Association. I think this is an ethnic group collection. Would this be something that would be considered in the light of a charitable group?

DR. TUSHINGHAM: I am sorry, I cannot answer this specifically, but I think so, yes.

MR. WATT: I might draw your attention, sir, to the definition of museum which is in appendix B. As Dr. Tushingham has pointed out, this is not yet in the Association by-laws, but it is quite explicit in there that an institution, to qualify as such, must have its exhibits available and open to the public. There will undoubtedly be certain regulations as tothe minimum length of time that these can be exhibited, but I think the intention is that members of the Association do have their collections available for public viewing.

COMMISSIONER PERRY: Is there a French area here where there are institutions which are somewhat like museums but they do not quite qualify?

DR. TUSHINGHAM: Yes, sir. There are several private museums in Canada. There is one perhaps which you know in Niagara Falls, Ontario, very near the bridge, which is a completely privately owned museum, operated forprofit. Such a museum does not qualify under our definition of a museum, and so that

museum is not a member of our Association and would not qualify under any of the tax reliefs that we are suggesting.

COMMISSIONER WALLS: The word "non-profit" does not actually mean it is non-charge?

DR. TUSHINGHAM: No, sir.

THE CHAIRMAN: Why should Section 27 (1) (a) be extended to take care of gifts in kind? If it is good enough now, all we need is to start to use it. Is that not right?

DR. TUSHINGHAM: Sir, the way it is now phrased, gifts in kind are not specifically allowed for, and it is necessary at present to change a gift in kind in some way into a gift of money, and this has been done for some years by an exchange of cheques which serves the purpose, but seems to be a rather round-about way of achieving the purposes which I think the Act was intended to cover. Therefore, we were asking the law be so rephrased that the gifts of objects be specifically permitted, and this of course requires the setting up of some evaluation machinery, some third party, to advise the Government on what evaluation should be put on the object for income tax relief.

THE CHAIRMAN: Again I don't know why that should be spelled into the Act. I can understand that the Act might deny certain things which would otherwise follow, but so long as it does not prohibit gifts in kind, I don't know why people don't proceed with gifts in kind. Of course there is the matter

of being able to defer deduction over a number of years which you mention later on in here. I would have thought that the law is not particularly unsatisfactory. I have always been curious as to why people haven't made more of gifts in kind in this country. As you know, it is more common in the United States.

MR. WATT: One of the principal reasons for that stems from a decision which was handed down a few years ago which implied quite explicitly that gifts in kind were not anticipated under the Act or were not deductible under the Act. The reference to amounts necessarily limiting donations to those made in cash or in money.

While there is a certain amount of disagreement as to whether this is in fact the interpretation of the Act, I think that has served to cloud the issue somewhat; while it may well be that the Act, as it is presently worded, does allow for gifts in kind, because of what has happened in the past it may be advisable nonetheless for some specific mention to be made of gifts in kind which would at least serve to clear this area of doubt.

THE CHAIRMAN: Where do we find that case? Is that the note at the bottom of Page 5?

MR. WATT: No, sir, that note at the bottom of Page 5 is reference to one of the United States rulings in connection with the example that I have given there. We didn't refer to this particular case in our brief.

THE CHAIRMAN: At your convenience you might

let us have it.

MR. WATT: I would be glad to do that.

COMMISSIONER PERRY: It is a case under the present Act, is it, Mr. Watt?

MR. WATT: Yes.

COMMISSIONER WALLS: I take it you are now suggesting that the Department of National Revenue should, with the agreement of the museums, pick certain people as official assessors? Is that not what you have said?

MR. WATT: I don't think we would necessarily intend that they be official assessors, but rather that they are a source of advice.

COMMISSIONER WALLS: They would have to be approved assessors?

MR. WATT: Yes, they would have to be acceptable, certainly.

COMMISSIONER WALLS: Who would pay for the cost of the assessing in a case like this? Would it be the museum or the donor, or would you feel that the Department of National Revenue should pay for that?

DR. TUSHINGHAM: If I may speak for the C.M.A., I would think that the museum which was receiving the donation should probably make the arrangements for what payment is required.

THE CHAIRMAN: I think it goes without saying the Government would not pay for it. It would have to be written into the Act, and it would never get there.

DR. TUSHINGHAM: I am quite sure, sir, that if, for instance, reputable dealers were involved in this, they would probably provide this service gratis.

THE CHAIRMAN: Yes, I think you are probably right. There is a fair amount of this kind of appraisal done now on estate taxes, and what you are really suggesting could be extended to this purpose, but there is procedure developed for estate taxes.

MR. WITHROW: One of the reasons that we have included the section on evaluation is that some of the objects are rather difficult to evaluate. My interest is particularly in art, and I was admonished by my colleagues in other museums to make sure whenever it mentions objects to make sure it is quite clear it included specimens. They might be geological or biological specimens and so on, and those things are very difficult to evaluate.

DR. TUSHINGHAM: One of the problems we have faced at the Royal Ontario Museum is that the very breadth of our collection means we receive objects for which there is no evaluators in Canada. No one will know the price of tusks and bronzes, or what have you.

What it comes down to then, one of the interested parties, the museum, is in a position to put a value on the objects, and this puts us in a very awkward position of having to ask that donor perhaps who may have a very good reason for believing the worth of the value is higher than we wish to put on it. We are trying to get this problem out of our

hands too -- to have a third party.

THE CHAIRMAN: When you say "we", you are speaking as an individual member of your Association, but if a charge were made on your Association to ever evaluate or tell the Department where the evaluation could be secured, that would not be unfair I would suggest.

DR. TUSHINGHAM: Are you suggesting that the Association as such would recommend to the Government a proper evaluator in a certain case?

THE CHAIRMAN: Either that or provide an evaluation.

DR. TUSHINGHAM: I doubt with the set-up of our organization that could be done. We have no paid secretariat in the Association.

THE CHAIRMAN: I dare say it would be difficult then. However, I do not think that represents a very real difficulty. I would have thought one could secure evaluations one way or another on virtually anything.

Now, I am interested in your solution as to a gift with a reservation of its use during its lifetime, which I understand is quite a common practice elsewhere. I don't know whether in the United States they follow this solution.

What you suggest seems to me to be perfectly reasonable. If one reserves the use of it during his lifetime, one evaluation is discounted by its actuarially established lifetime at appropriate cost of money and the donor would secure a deduction from

the present value. That is what you have in mind?

DR. TUSHINGHAM: Yes, sir.

DR. TUSHINGHAM: Yes, sir. This would also have an advantage for the Government or the museum involved. Quite frequently objects appreciate substantially in value and in the, say, 20 years between a man's gift of an object to the museum and his death that object could well increase in value three or four times but he would be getting income tax relief on it at the time it was given.

THE CHAIRMAN: At the lower value?

DR. TUSHINGHAM: It would not be the deduction from government revenue that it would be normally.

THE CHAIRMAN: Do works of art never depreciate?

DR. TUSHINGHAM: Oh, yes, they do, sir. In today's market I think most of them appreciate.

COMMISSIONER WALLS: The same would not apply to an exhibit in an aquarium?

DR. TUSHINGHAM: Yes, sir. Even with aquaria some specimens become rare all the time and the cost of acquiring them goes up.

COMMISSIONER WALLS: I meant that the one you already held would not appreciate in value?

DR. TUSHINGHAM: By producing dividends!

THE CHAIRMAN: Little dividends!

At the top of page 6 you say:

"A taxpayer who by formal deed made a charitable contribution of one-half interest in an art object, subject to his retention of custody during

his life, is entitled to a deduction of the present value of the remaining interest transferred."

I must say I don't fully understand how a donor would come to make a gift of half. What kind of a transaction is that? Could you describe it?

MR. WATT: I think this particular example and the preceding one are examples of two situations apparently ruled on in the United States Revenue. The Ruling Reference will indicate when. I think the basic principle involved in the U.S. in a lot of these cases is where a donor or a receptor, as the case may be, will retain some interest in the property. It requires that an interest in the title to the property must pass to the charitable institution.

This particular situation that was outlined here is that one-half interest in the ownership of the property of the art object was transferred at the time to the charitable organization but the man retained the use of the object, the custody of it, throughout the remainder of his life.

Now the present value of the remaining interest transferred was, of course, half of the value of the object at the time of the gift, reduced by the appropriate factor, based as you suggested earlier on his life expectancy, and at an appropriate rate of interest for the use of money.

THE CHAIRMAN: What has the "half" got to do with it? I don't understand why you are dividing it into two equal parts?

MR. WATTS: The other half interest

is presumably bequeathed to somebody other than the charitable organization.

THE CHAIRMAN: I think I would be glad to see this kind of transaction ruled out completely I don't think anybody would know where they stood at all.

DR. TUSHINGHAM: I don't think Mr. Watt has understood the situation as it really applies with museums. The half interest is of use to the museum and to the donor for immediate tax release and to the museum because they have a hold on an object. If they did not have a half interest in it when the owner dies it is quite possible for some reason it would be swept away in the estate and sold off and so on.

By having a half interest this is good for the museum. The other half interest that is still held by the donor will come to the museum at the owner's death as part of his estate that is normally retained.

I think, sir, they have complicated the issue in the United States greatly by allowing the man to give an object to the museum on a 6-months out of the year basis.

THE CHAIRMAN: I know they do that and I would have thought that is a very difficult thing to make a deduction for. I suppose one draws a contract with the museum and gives certain works of art on condition that he gets them back for half the year for the rest of his life time and then you deduct one

half of what you would deduct if you got them back for the entire time and had the full use of them.

DR. TUSHINGHAM: That is right.

MR. WATT: I think in any event the title to the object is passed to the institution with the reservation of some interest, being perhaps the use of the object for 6 months of the year for the remainder of his life, or that of his wife, or something of that type. The title normally passes at the time of the gift with some reservation of interest.

THE CHAIRMAN: I am quite sure it does. I didn't know they made a deduction in the United States for the right to use the property during the life time. I had not heard that.

DR. TUSHINGHAM: I think you can see the advantage to the museum. There are cases we know of of men who own art objects and who are quite prepared to give them to the museum if they stayed in their estate until death. Almost anything can happen if they remain in their possession until death. Almost anything can happen. A man could die suddenly of a heart attack and it would be discovered they would have to sell off the art collection to meet the estate tax.

If the tax law makes it possible for him to transfer now to the museum some large interest in this and get a tax deductability for the whole thing now the museum's interest in this collection is protected.

We have several very good cases of this where we are afraid it will be necessary to sell the collection. That normally means selling it the other

side of the border. We have a hundred years or more of experience of Canadian collections being broken up and being sold out of the country because our tax structure and other reasons have not made it easy to transfer the collection to a museum in Canada.

THE CHAIRMAN: I am curious why the law will not permit you to do that. I am interested in seeing the particular case to which you refer. I am surprised people have tried to use it for this purpose.

DR. TUSHINGHAM: If the law could be clarified, for instance if the value of the collection is worth a hundred thousand dollars, so that the amount could be deducted over a period of years instead of in the one year. The law states "Gifts made by the taxpayer in the year."

THE CHAIRMAN: I think you are producing quite a complicated factor in requesting the right to spread gifts. If that right were given it would have to be clearly defined and properly restricted. It would not only be gifts in kind but monies also. That has been tried before in requests to the government over the years and successfully resisted by the government as something which requires a description. It is very hard to draw a description for this.

I don't see how the law can permit averaging without carefully defining howit is to be done. It can, of course, be arranged possibly by a sale and then a gift back of the debt which is

incurred by the sale. I don't see how that could be stopped.

MR. WATT: I think this is why the Conference of the Arts suggested the life time cumulative deduction which would be in addition to the specified annual deduction allowed to the taxpayer. This is a principle that is not entirely new in Canada.

We have the ten thousand dollars once-in-a-lifetime gift of interest in real property to a spouse or interest in farm property to a child. That is the once-in-a-lifetime illustration.

Perhaps an example could be the gift tax provisions in the United States where there is a certain minimum annual individual tax exemption provided and in addition to that there is also a cumulative. I believe there is a thirty thousand dollar exemption which an individual can use up over his life as he sees fit, taking such part of it as may be necessary in any one or more years when he makes gifts in excess of the gift tax exemption.

I think that is a principle that may go some way towards allowing the spreading of gifts but it does provide a mechanism whereby the total amount can be controlled by the revenue.

THE CHAIRMAN: Shall we move on to section 11: Limitation on deductions for charitable donations? You would like the minimum raised from 10% to 20%. I don't think we have seen very good evidence to support an increase from 10% to 20%. I think it is true some people give

away more than 10% of their income but I suggest those gifts are not out of income they are out of capital. I am not sure in order to accommodate those people that one should raise the 10%.

I am very doubtful whether there are many people in this country giving away more than 10% of their income before taxes regularly.

MR. WITHROW: We are aware the cases are few but the few cases are very crucial for the museums. There is a Bill going through in the States right now which contains a provision whereby the museums will be classed as educational institutions and therefore will come under the 30% allowable. I can see your point from the revenue side but from the museum's side this is a hardship compared to the American museums which receive very large gifts.

THE CHAIRMAN: When we don't tax capital gains in Canada it would seem unfair to allow people who make money out of capital gains to go back and secure a deduction from taxable income.

MR. WITHROW: I see your logic very clearly but from our point of view it doesn't help.

COMMISSIONER WALLS: Especially when we have not begun to exploit the "up to 10%" of either corporation or personal income tax. In other words, there are many, many people who could donate a good deal more to charitable donations. We haven't begun to exploit the field that is already tax free.

MR. WITHROW: I realize the percentage of people paying enough to come near that is very small.

These are the very people who support the arts, the people who are paying above their 10%.

THE CHAIRMAN: I suppose the fact that the 10% deduction is being abused in certain quarters is not a very good reason for restricting it to 10%. The right answer should be that we should police the abuse rather than do this.

I think until the abuse is cured the custodians of our revenue would be most reluctant to make further concessions. I think if one looks at the national statistics, the national taxation statistics, the reason is pretty obvious.

MR. WATT: I think I might make two points, sir. One is the fact that the present limitations do not appear, as far as can be ascertained from the statistics, to be reached over all. I think the p oint that was made by Mr. Withrow that a few taxpayers may well be using up their limit, and perhaps exceeding it, is quite easily understood when one appreciates the fact that one art object may have a value considerably in excess of the limit in one particular year. This, of course, may go a long way towards the potential donor not making a gift of that art object if he is only going to be allowed to deduct that part of its value up to 10% of his income.

I think this is a problem where income may be of a fairly level amount whereas the value of the donations to be given may vary considerably. Sometimes cash amounts given in one year would be well within the limit but one or two art objects given in

another year could well exceed the limit. This results in a certain amount of inflexibility, I think.

The other point which may be commented on may be a little inappropriate in these circumstances. I think it warrants mentioning. As has been pointed out it has been not unusual for valuable art objects in Canada to have to be sold out of the country for various reasons. Furthermore, there is quite a lot of activity on the part of the government in the supporting of cultural pursuits and intellectual activities in the country.

The effect of raising this limit from 10% to 20%, if it results in any increase in donations, apart from those few individuals who would be in a position to make use of that limit, it may work out to be a rather cheap way on the part of the Government in supporting the accumulation of cultural objects which otherwise the Government may have to buy back or contribute 100% of the value through the form of grants of one kind or another.

THE CHAIRMAN: You may be quite right. Perhaps that is the best way of achieving this result. If I spoke of abuses a minute ago all I meant was it is alleged before this Commission there are abuses. I don't know whether there are or not. It could be a very exaggerated statement.

I just think there are a few people who would be able to take any benefit whatsoever of an increase beyond the 10%. Theremay be a few.

MR. WATT: Which would incidate the cost

to the revenue may be fairly small by the very fact that economically not very many people would be able to take advantage of this. It would allow the flexibility which may be needed in a situation of this kind where extremely valuable objects can only be given once after all and at the time they are given the limitation as to percentage of income may be well below the value of the object.

I might add that the preceding section of the brief which discussed the ability of the taxpayer to give interests in art objects may to some extent overcome this factor of inflexibility. Instead of him having to give the object entirely, and not be able to retain any interest in it, he could not reduce the value of his gift if he wants tomake a donation of an object. Were he able to retain some interest it would be valued and deducted from the value of the object in arriving at the amount of the charitable donation. This may be some way to avoid the inflexibility I referred to.

DR. TUSHINGHAM: I think that the most important donors or supporters of the museums are not the very wealthy in Canada nor the corporations. They are the medium welathy people whohave in that 10% deductability quite a definite low level of deductability. We have in Toronto certain people I could name, three or four who have their difficulties at the end of each year keeping their donations within the 10%. They have far more they eant to give us but at present it is not feasible.

If, for instance, 20% were allowed we would get from them, I am quite sure, 20%. I admit there would be perhaps no more than one hundred such people in Canada but these one hundred people are the backbone, the absolutely necessary support of the nuseum and art gallery movement in Canada so we want to encourage them.

THE CHAIRMAN: What occurs to me is perhaps a desirable solution of that, to provide a separate category for donations for the purpose of education and for museums and art galleries. Now perhaps that should be extended beyond that to libraries.

DR. TUSHINGHAM: Yes, that sounds like a possible solution.

MR. WITHROW: This is the practice in the States where museums have been called very recently educational institutions and they receive the same benefit as universities which once again is 30%.

THE CHAIRMAN: It may be possible to reduce the other categories if one put those things out of it. I don't know. I will have to consider it.

COMMISSIONER MILNE: I am not absolutely certain, Mr. Chairman, why the 20% figure was chosen here. Do you think there are not too many people involved? I am not absolutely certain from what you have said if you think there are not too many people who could go beyond that 20% or do you think this is the best percentage place to stop?

MR. WATT: The brief does say "at least 20%." It is rather difficult to decide where a

line should be drawn there.

MR. WITHROW: We were thinking of 20% because museums in the States were at 20% when we began to think about this.

THE CHAIRMAN: It seems like a nice round figure.

DR. TUSHINGHAM: Museums in the States are now going to 30% if the new tax law is passed. If you are involved in this at present it may be considered unnecessary to set an upper limit of tax deductability for cultural institutions if this special category was created.

THE CHAIRMAN: I would be inclined to think we might have instances of great philanthropists who would give huge sums of money to education and if there were no limit on the amount they could give away by virtue of their donations they would pay no taxes for the rest of their lives unless they gratuitously wished to do so.

DR. TUSHINGHAM: Would this not be an advantage to the Government if the Government does not have to in turn subsidize the museums and art galleries directly?

THE CHAIRMAN: It might be an advantage to the Government. On the other hand it might provide very poor social justice and the Government is not only concerned about getting money but spreading the money among the citizens, taking away and giving it to them. This might upset the balance rather badly.

DR. TUSHINGHAM: In giving it to an

educational institution they are giving it to the people, allowing it to go to the people.

COMMSIIONER PERRY: Could you tell us how in practice the differential allowance works in the United States? I assume that most of the people giving the 10% are not giving it all to museums but this is a mixture of donations of all sorts and if one wants to go beyond that it might be a mixture of donations that would take them beyond that.

DR. TUSHINGHAM: This is a question in the nature of the case that we cannot answer. With most donors in this position we don't know their annual income or what other charitable donations they make. We know when it comes to donations for art galleries they have a certain amount which they can give to us in that year.

COMMISSIONER PERRY: We will have to have some details on the American thing before we can consider it very well.

THE CHAIRMAN: I think you have made your point very clear to us. I fully understand what you have put before us. Certainly I am sure we are all sympathetic to your proposal. Whether this is the best way of achieving what you seek to achieve I don't know. I can assure you we will continue to consider it seriously.

It might be though that you could find a faster cure by persuading my Member to sponsor a private Bill. Of course he may not get elected in his next time around'.

MR. GELBER: Your private Member cannot sponsor a Bill that effects the Exchequer.

THE CHAIRMAN: I don't know that much about it. Thank you very much indeed, gentlemen. We will break off for ten minutes.

--- Recess

---On Resuming

THE CHAIRMAN: Mr. Alexandor, we have a submission from the Canadian Association of Social Workers. You are not speaking for them?

MR. ALEXANDOR: No, Mr. Chairman.

THE CHAIRMAN: They refer to your submission.

MR. ALEXANDOR: I think as an organization they have seen our submission, but I don't think we have seen theirs.

THE CHAIRMAN: We have read what you have put before us with considerable interest. Before we get to it, we must enter it into the record. Mr. Secretary, would you proceed?

THE SECRETARY: Mr. Chairman, I am sure you are quite familiar with the people who are here to present this brief this morning. Mr. Alexandor will say a few words in opening remarks, and introduce his colleagues. I wish to enter the brief into the record as Exhibit 281.

---EXHIBIT NO. 281: Brief of the Canadian Welfare Council.

<u>SUBMISSION OF</u>

<u>CANADIAN WELFARE COUNCIL</u>

Appearances:
MR. B. M. ALEXANDOR, Q.C.
MR. REUBEN C. BAETZ
DR. GEORGE M. HOUGHAM
MR. BERNARD LALANDE
MR. HENRY STUBBINS

THE CHAIRMAN: Thank you, Mr. Secretary. We

don't need to read this. We have all been through it. We endeavour to conduct these sessions as informally as possible consistent with keeping the record clear. Stand or not as you please. We will have questions to put to you, but before we do so, Mr. Alexandor, would you like to say anything?

MR. ALEXANDOR: Just briefly, Mr. Chairman, and members of the Commission, first of all to express regrets of three people whose names were put down as part of our delegation who are not here: Professor Morgan, Mr. Lemay and Mr. Anderson unfortunately found it impossible fairly close to the last minute to be able to come.

On my right is Mr. Henry Stubbins, Chairman of the Committee that is referred to in the introductory part of our statement. On my left, Dr. George Hougham, formerly Research Director of Canadian Welfare Council, and next to him, Reuben C. Baetz, Executive Director, Canadian Welfare Council; Mr. Bernard Lalande, Director of Public Relations for the Welfare Council.

I have nothing to say as introductory remarks. You are familiar with our organization. I think perhaps the introductory statement on the first page indicates to the other members of the Commission what the Canadian Welfare Council stands for. I take it you do not want the recommendations read. There is a summary of them at the beginning. They occupy about seven or eight pages.

THE CHAIRMAN: No, it is not necessary.

MR. ALEXANDOR: If that is so, I think we,

and when I say "we" I mean the technical experts that surround me, are prepared to answer the questions, I hope, that you will ask.

THE CHAIRMAN: Before we get to the taxation aspects, do any of you wish to put questions with regard to the organization and nature of the Canadian Welfare Council.

COMMISSIONER MILNE: In this respect I certainly know that your Council has a very wide membership. It is expressed in your initial sentence how wide is the group of persons in the country who feel a tremendous interest in the work which the Council does. My question really relates to the paragraph in which you state that you are indebted to a number of individual members and local groups who contributed to the invitation to study the draft, and I was wondering how wide through your membership was the draft circulated.

MR. STUBBINS: We did two or three drafts which circulated widely by mail across the country at different stages of preparation, and comments were sent back by various individuals and organizations, welfare councils and other direct service agencies and people.

Our Secretary, Dr. Hougham himself, took a tour across the country from Montreal to the West Coast, and actually personally met with several of our groups in many of the larger cities across Canada, and was able to get direct oral reactions to the brief, so that all these things were incorporated and were reviewed by the Committee which met perhaps seven or eight times in the course of a year.

COMMISSIONER MILNE: Actually the draft of your submission has really had wide circulation throughout the country?

MR. STUBBINS: Yes.

THE CHAIRMAN: Now, you have prepared this in a form which summarizes your recommendations in the beginning, and then deals with them in more detail commencing on Page 12. I would have thought, therefore, that we could skip the summary and go to the main body. Some of us have underlined the summary, and have made notes on it, so we can keep our eyes on both.

I think we can now move to Page 12. I am pleased to see that you make the point right off the bat that social welfare programmes and social services both are an essential part and partner in the modern economy, and that is irrespective of whether the economy is working well or is not working well.

COMMISSIONER PERRY: I think most of these comments are put in such a way that they are hardly arguable, but I was wondering whether anybody in the delegation would care to pass judgment on the recent performance of fiscal policy in Canada in relation to these objectives. Perhaps "recent" is the wrong word. "Recent" going back perhaps a year.

THE CHAIRMAN: Not necessarily commenting on the last budget.

COMMISSIONER PERRY: Nor current events.

DR. HOUGHAM: I would make one comment in relation to Mr. Perry's question, not in the way of a general comment, but I think somewhere in the document

and I cannot recall exactly where we referred to it. Perhaps it is right in this section that our unemployment insurance programme is used as an example. If there is a particularly heavy burden in recent years because of the failure of the economy, whether through the action of Government or whatever to maintain a sufficiently high level of employment. We see a direct relationship between fiscal and other aspects of public policy and the operation, if you like, of the economy as a whole and social welfare programmes and social services.

COMMISSIONER WALLS: In dealing with that on Page 14 you say "unless Canada's tax and social systems are developed and administered in a balanced fashion, it is quite possible for policy in one of the two fields to conflict with, and even to defeat, policy in the other."

If a form of social security is out of hand to the extent that the plan in force becomes actuarially unsound, should a taxation formula be expected to correct such a situation? You deal with unemployment insurance, and that is what happened with the unemployment insurance fund; it became actuarially unsound.

Does the correction lie with taxation, or does the correction lie in recreating the fund, it being actuarially unsound.

DR. HOUGHAM: I think it lies in part, Mr. Chairman, with fiscal policy, or at least it has an impact on fiscal policy because none of the effects surely of the high level of unemployment, and therefore, particularly heavy burden on the unemployment insurance

system, has been an increase in the number of people who are no longer covered by unemployment insurance. Therefore, they have become a public charge through public assistance, which is financed directly through the tax system.

COMMISSIONER WALLS: But it was not unemployment that created the problem with the unemployment insurance fund. It was an extension of the benefits beyond where it was originally created and actuarially set for, plus the fact it then included another classification who had not been in that fund before. Had the fund been left actuarially sound it would have taken care of the unemployment situation, would it not?

MR. STUBBINS: Wasn't one of the problems that the unemployment insurance fund was used for other purposes because there were no provisions to cover these other risks? We might have had a healthier balance in the fund if there had been other social welfares. I am thinking of maternity benefits.

It has been used for different types of seasonal unemployment. It has been used to cover more than just temporary unemployment which was originally envisaged.

COMMISSIONER WALLS: Shouldn't the rate have been increased? We run into the question then of whether it becomes an insurance fund or welfare proposition, and we had better admit which one it is, hadn't we? If it is going to be welfare, then I agree the state must by taxation step in, but if we are going to call it an insurance fund and to any extent make it self-

sufficient, it should be actuarially sound. If you take on additional bodies that are not covered, then you should increase your rate to cover it.

DR. HOUGHAM: I think we would agree with this one limitation, and that is depending on what you mean by "actuarially sound" because as we pointed out somewhere in the submission, in some of these programmes of which unemployment insurance is an example, you have some internal subsidy within the system. It is not operating on an actuarially sound basis in the sense that private or commercial insurance operations are required. As long as you have some internal subsidy operating -- the programme is almost by definition quite simply an insurance programme. It also has social welfare objectives.

It seems to me, speaking broadly, it then becomes a question of how much you want to incorporate into the programme the social welfare objective. To go back to your original questions, the Council's position broadly would be that in any programme such as unemployment insurance you are going to run into real problems if you try to introduce too much of this social welfare component, and I think the unemployment insurance programme is an illustration of this.

COMMISSIONER PERRY: Just in a very general way I suppose even a fiscal policy which produced the ultimate desirable rate of growth, the ultimate in full employment, would still leave a great residual of problems in the social welfare field. In other words,

you are not exclusively concerned with having people fully employed?

DR. HOUGHAM: No, indeed, I think this is the point we were trying to make in No. 2, which begins on Page 12 and goes on to Page 13. Even with what everyone calls full employment, there is a continuing role for social security measures, public and voluntary. It is in the nature of a dynamic society to require these services even if you have a healthy economy.

COMMISSIONER PERRY: Another way to get at my original question would be to ask whether in recent years you think too much has been expected of the social welfare apparatus.

MR. STUBBINS: Insofar as people would expect it to take care of problems resulting from large-scale unemployment, then I suppose the answer is yes, too much is expected, because social welfare cannot possibly compensate for lack of employment on a large scale.

There are things that go beyond social welfare; housing, school drop-outs and things of that sort. These are things that affect other segments of the country than social welfare.

THE CHAIRMAN: One of the most unpopular aspects of the welfare programme has been the transferring of funds to people who are not in need, to which you refer on Page 15. You say "the real objective of the programme is to encourage a higher level of consumer spending by redistributing purchasing power rather than to meet a welfare need."

That is something that gets into our welfare

programmes, and over the years I have wondered whether it is well placed there; whether in fact our welfare programmes were designed to accomplish this or whether brought in without design.

Do you think the people who planned our social security intended really in doing so to transfer funds from some of our citizens to other citizens who are not in need?

DR. HOUGHAM: Well, Mr. Chairman, I think you would have to deal with this in terms of the specific programme. An example I would like to use would be family allowance. If you go back to the original history of family allowances, it would seem to me there was no question at the time the programme was introduced it was certainly as much with an economic intent as it was welfare intent.

That programme came in around the end of the War when the great concern was that there would be a slump after the War, and there was a variety of policies being developed to try and counteract this; to provide an increase in consumer purchasing power. It was only in part a welfare programme that was envisaged at the time the programme was introduced.

THE CHAIRMAN: That surprises me indeed. I remember this being accepted by the Canadian public as a means of getting milk to growing children, and I am surprised to hear it was largely put into effect for economic reasons.

DR. HOUGHAM: It was my impression that was at least one of the objectives.

MR. STUBBINS: It is hard to measure reasons in this thing, but I think our point or criticism was to the effect is it a social security expenditure in this country or economic expenditure? They are not entirely 100 per cent social welfare, and these other motivations do enter into the framework of the legislation.

THE CHAIRMAN: In trying to find out the purposes of this legislation, I thought they perhaps served an economic purpose, but that was incidental only; they were designed for a social purpose, and the economic purpose came in, but Dr. Hougham was quite persuaded in this regard it was for economic purposes.

COMMISSIONER PERRY: I can assure you the people who designed this programme were economists. I would also refer to a very violent editorial in the Economist some years ago in which it was insisted that economists are interested in human welfare, which seems to be forgotten sometimes.

MR. BAETZ: Isn't it true, particularly in recent years -- and I first ran into this in undeveloped countries where there is growing recognition of social development, where do you draw the line between social development and economic development?

To invest monies in schools, hospitals, public health programmes, it is economic development as well as social development. I think this is something we sometimes tend to forget. We think that money directed to social welfare programmes is so much money down the drain when in effect this is also part of

our economic -- if you want to use that term -- economic development. Measures to reduce the rate of juvenile delinquency, measures to cut down school drop-outs might be termed social welfare measures, and might be considered by some people as money down the drain, as I said before, but in effect this is all part and parcel of the economic development of the country.

THEE CHAIRMAN: Isn't it time the sociologists started to point out that the great economic advantage of welfare programmes I think is lost sight of? In fact, to carry on with what you are saying, businessmen discussing welfare speak about it most callously as a burden they have to bear.

It seems to me if programmes were brought into effect partly for the economic benefits of the programme, and I suspect they were, that has very seldom been explained, and I am rather surprised with Dr. Hougham's reply, but I suspect it is correct. With regard to old age security, transfer of payments there of the same kind we spoke of before, were they put before us as having been an economic benefit at the time? I have forgotten if they were.

MR. HOUGHAM: I think one of the problems is that the economists, as Mr. Perry has suggested, may be quite sensitive to the aspects of the program. They don't lend themselves to the traditional tools of economic analysis. Input and output is a statistical measurement of investment, if you like, that you get in the private enterprise sector of the economy. It is difficult to measure the benefits.

There has been some effort in recent years in education to figure out what the economic return is of an investment in an individual university education. This kind of thing is very difficult to do.

THE CHAIRMAN: The stability benefits of welfare payments can be measured, I assume.

COMMISSIONER PERRY: Our staff are trying to do this. It is very difficult, Mr. Chairman. If you assume that the great bulk of the tax revenues comes from people who would be ordinarily spending most of their income anyway then you are changing the form of expenditure perhaps through this operation.

MR. HOUGHAM: I think this is not a very important point. One gets the general impression from looking at tax statistics, leaving aside the corporate tax and personal income tax factor, that a lot of this is income re-distribution within the same group.

Roughly speaking the lower and middle income groups are bearing the heavier proportion of the total tax but they are also the people that get benefit.

COMMISSIONER PERRY: It is the less poor helping the poor.

THE CHAIRMAN: Comparing the tax receipts with those of other countries we may be a loser because of the transfer payment the other countries may or may not have.

COMMISSIONER PERRY: I think that you will be interested in knowing that one of the staff studies is devoted to the re-distributional effects of taxation in the welfare program. To my knowledge it is the first serious attempt that has been made to examine this phenomena.

MR. HOUGHAM: We welcome that news.

THE CHAIRMAN: An page 16 you draw attention to "income in kind" and the lack of information there is with respect to income in kind. I suppose it is true that it increases considerably and impairs the tax base where wages are paid in kind rather than by cash. I wonder if there is much evidence that there is a substantial change in the nature of wage payments from cash to kind.

MR. HOUGHAM: One could only have impressions in those areas. Most of my impressions have been derived from United States studies. I think we would all agree that this is a growing trend. How significant it has become it is difficult to say.

COMMISSIONER WALLS: I have a supplementary question to that. Would you then suggest that all employment contracts and agreements that to any extent go beyond cash salary be subject to assessment of

income in kind by the Department of National Revenue.

MR. HOUGHAM: I had the impression this was already occurring to some extent.

THE CHAIRMAN: Yes, I think the law covers everything under the sun. I don't know they pick it all up but the law is there. Some is difficult to assess.

COMMISSIONER WALLS: If the corporation is tax free in the first place how do they have any record? How do they assess it? There is no means of the Government knowing about an employee of a tax free corporation as to whether they are paying salary in kind above salary in cash.

THE CHAIRMAN: There may be evasion. I don't think that is the point. The point is the law. The law is there and like all laws it may well be evaded. I don't know about that.

COMMISSIONER WALLS: Would you not be strengthened if all contracts that went beyond cash salary had to be assessed by the Department?

THE CHAIRMAN: Probably.

MR. HOUGHAM: I am raising a question to which I should know the answer but I don't. The Council is an organization of this kind. It is not a taxed organization but it has always been my impression that the kind of information we have to file on an annual basis with the government would provide this information.

THE CHAIRMAN: Every employer is required to file T4 returns and that picks up not only annual payments in cash but in kind. You are quite

right. I suppose there is evasion, there is always evasion in everything.

There may be areas which are doubtful but I was wondering if there was evidence that the doubtful area is increasing. I don't know. I am not aware of it. I do see there are companies that provide lunches below cost and I suspect they provide housing facilities below cost in outlying places and things of that kind.

MR. ALEXANDOR: The members of Parliament get meals below cost too in the Parliamentary Restaurant.

COMMISSIONER WALLS: In many cases it is advantageous for tax free Corporations not to show too high salaries but in order to get the caliber of people they want they have to give marginal benefits. To the best of my knowledge these marginal benefits are not shown.

THE CHAIRMAN: If they don't report the salaries they are breaking the law.

COMMISSIONER WALLS: They report the salary but not the salary in kind.

COMMISSIONER PERRY: You are concerned mainly with social justice, is that it? I thought perhaps that was the main emphasis but then you appear to attach quite a bit of importance simply to having a knowledge of what is going on.

MR. HOUGHAM: I think, Mr. Perry, before you can make a judgment you have to have the knowledge. I am coming back to the Chairman's

question as to the impression of how much of this there is. You hear a lot of stories about the growth of this kind of thing. I am not convinced myself that there is any significant amount of it. Until we know we cannot really make a judgment on either of the two points.

THE CHAIRMAN: It is dealt with in the reference that you put at the bottom of page 17 "Income Distribution and Social Change." I seem to have looked that book over and he makes some reference to this area. I am under the impression that we haven't advanced in sophistry to the same extent they have in the U.K. I know there are organizations there that make a good living selling meal tickets. This has never succeeded as far as I know in Canada.

MR. HOUGHAM: In relation tothis point, comment was made that follows along with what you are saying that we haven't advanced as far as the U.K. or the United States in this regard. I took that with some reservation because I felt it would sound like Canadians were parading their own virtue. I would simply like to know.

COMMISSIONER PERRY: What probably accounts for the largest part of this in value is exempt by statute under Section 5 (1a), which starts out with the sweeping statement that value of board, lodging, and other benefits of any kind whatsoever are to be taxed. There are then exceptions for the benefits from employers' contributions or under a registered pension fund or plan, a group sickness plan or accident insurance plan, medical services plan, supplementary unemployment benefit plan,

deferred profit sharing plan.

These probably account in dollars for most of the benefit.

You could probably make a long list of other things that get exemption under the table, as it were. This does not destroy the validity of the point but that aspect of income has to be examined.

MR. HOUGHAM: It has always struck me that part of the problem here is a problem of administration. The list that you read off seems to illustrate this. Aside from the evasion that the Chairman referred to earlier the measurement of income in kind, where the employer is making a direct monetary investment or payment, should be relatively simple.

You run into more difficulties when you get into such things as housing. How do you compute rent? You don't have to enter the private sphere to talk about this, the government in the public area may provide housing in certain circumstances at rents computed, rents which are not what you would pay on the open market.

THE CHAIRMAN: They know what one has to pay on the open market. It is simply a failure of assessment becuase they endeavour to arrive at the market value of rents. I am not speaking about the public or private factor. I have seen assessors try to do it. While they may fail to achieve what is desirable that is only because they have not pressed the point.

MR. STUBBINS: We were not thinking of

evasion but mainly in the area of judgment of what is a business expense, recognizing when you have a fairly steadily rising income tax rate in personal income tax there is going to be pressure on what falls on each side of the fence, as between business and personal expenses. Our interest here is we really did not know what the distribution of the income tax burden would be. We don't know how expensive it is.

COMMISSIONER WALLS: I see on page 18 that you indicate in the Income Tax structure we should perhaps think in terms of the family rather than the individual. Then you go on to need for more precise data.

I suppose what you mean by that is, first of all, the matter of a husband and wife working must be a matter of concern to welfare associations. First of all, is it a necessity for both spouses to be working to acquire an adequate standard of living.

It seems to me that there is a second factor to that that maybe is not considered and that is the shortage of trained people of a certain category. This requires the married woman to go back to work or it does provide an inducement, whether or not they require it for an adequate standard of living.

There is, for instance, a shortage of secretaries and stenographers which in many cases has forced the married women to go back to work. If you prevent that then, of course, you are only going to create other serious problems because you will have the single girls all becoming stenographers instead of

school teachers or nurses because of the salary scale relationship.

I agree with you that the whole matter of reviewing any change in the status of income tax with respect to the family must be viewed from a welfare standpoint and this type of information assembled.

THE CHAIRMAN: Your point with regard to the married woman is that the tax laws should be neutral?

MR. HOUGHAM: Yes. I have a reservation about what Mr. Walls said. It is my impression in the social welfarefield that the position is taken that public policy should not discourage the married woman from working. It is not a question, it seems to me, of need or necessity because this beomces a matter of individual judgment above the level of subsistance. It is a matter of individual judgment. It ignores, it seems to me, the very important element in this to which you have alluded, which is the contribution which married women working makes to the economy and the society.

THE CHAIRMAN: What is neutrality? I suppose it might be answered perhaps that a benefit to the married woman working would be the same benefit to the unmarried woman working. The fact she is part of the family unit would not affect the benefit she gets from going to work.

In the U.K. they have worked it out. It is not quite for the reason stated here, I think it is more for economic reasons, being able to achieve

a deduction from the payroll in a satisfactory manner.

MR. STUBBINS: There is one point in respect of neutrality that we make in the brief. That is that a married woman should have the right to have some reasonable limit on the cost of raising her children as an expense just as professional people are allowed to charge certain expenses against income. We thought this might be something to be considered by the tax authorities, allowing her to make certain resonable deductions that would tend to increase the neutrality, if you like.

THE CHAIRMAN: Yes, I quite agree.

MR. HOUGHAM: I think we are ducking your other question. I, for one, don't feel I know enough of the technical aspects of the impact of taxation to answer effectively. I don't know if what we are looking for in the tax system puts the married and single women in the same position.

THE CHAIRMAN: You mean she should be able to choose whether or not to go to work, having regard to considerations other than tax?

MR. HOUGHAM: I think this may be very difficult to operate in relation to the tax system. This is the objective of the idea.

MR. BOETZ: I saw statistics a few weeks ago which showed there are many more married women in the working force today than unmarried women, which is quite different from the war time or the pre-war time experiences. The statistics also showed that within families earning less than $4000 a year 75%

of the women indicated the reason for working was to bring the family income up to the $4000 level.

It is no longer a question of whether a married woman with children should or should not work. The fact of life is that many today have to work.

MR. ALEXANDOR: This is explained in the study you were looking at. There is a sociological change. The average age at which women today get married is very much lower than it was. This perhaps creates a larger supply of married women on the labour market than would be otherwise.

COMMISSIONER WALLS: You mean they get tired of us that much sooner and they are that much more anxious to get a job!

MR. HOUGHAM: That applies to both ends of the wage scale. If a woman gets married earlier and her children grow up earlier she then goes back to the labour force. What I was concerned to avoid was a notion in the public policy that you should relate this to need.

This suggestion came up in the Unemployment Insurance Act that we should limit the Unemployment Insurance benefits to married women because they did not need the benefit. I don't think you can do that in this way.

THE CHAIRMAN: I don't think you can say that more married women are working because of need than before. I think an awful lot of married women are working not because it is essential that they work in order to achieve the minimum living standard, but

they work in order to better the general standard of their family.

MR. BOETZ: What is need; or want? This is a changing concept.

THE CHAIRMAN: I am challenging what was said originally that they are working because they have to work. I don't think that is the case compared to what it used to be.

MR. STUBBINS: Apparently a significant proportion work because they have to work. I think both things are true. The younger the woman is married the less well established the couple is and the lower the income. When the children are educated and grown up the woman can go back to work. They get satisfaction. I think both things apply.

MR. HOUGHAM: The second topic to which you referred is of growing importance because there has been some statistics, which I seem to recall, that suggest that the proportion of married women working past the age where the children are grown is in the high income groups. These, broadly speaking, are women with higher levels of education and they want to get back into some sort of satisfying occupation, get back into the labour force.

MR. ALEXANDOR: There is a great need for them, for school teachers, nurses, and social workers.

COMMISSIONER PERRY: Alnost anyone who is working has to work simply because they have established a standard of living which they can only

support by working. In this sense the man with a $75,000 a year salary is in as great need as anyone.

I was going to suggest a question here. I don't think it is simply a matter of how a married woman is treated in relation to the single woman but how her husband and children are treated once she starts to work. In a sense we had neutrality in this country because married women and single women are taxed in the same way but the husband certainly is not taxed in the same way once his wife starts to work. I think this is a question rather of how the individual families are taxed.

MR. HOUGHAM: This comes back to the broader issue. We are not technical experts in the tax field. We have the feeling that the tas system doesnot take adequate account of the family unit.

COMMISSIONER PERRY: I think it broadens out to how the family is taxed rather than the individual.

THE CHAIRMAN: We are one of the few countries that don't have complete regard to the family in taxation.

COMMISSIONER WALLS: On Page 21 I just want to get your reaction to your paragraph 3 there where you seem to be firm in your opinion that the benefits under social securities measures such as old age security pension, family allowance, unemployment insurance, should be financed entirely out of general revenue. Now, why should they be financed out of general revenue rather than created again on an actuarial basis and collected by salary deduction and employer contribution for the most part?

What is the reason for wanting it to come out of general revenue rather than have the individual know what he is contributing towards it?

DR. HOUGHAM: You can let the individual know through earmarking, although it is a debateable point as to what the psychological impact of this is on people. I would think more broadly in answering your question at least one of the arguments is that if a benefit is universal, and let us use the old age pension as an illustration, why should you require employers and employees to finance this programme when a lot of people are going to be getting the benefits whose earning areas are not in that kind of contractual relationship? Take as an example the farmers.

COMMISSIONER WALLS: Isn't that a true form of ~~avoiding~~ regression? What you are in effect doing is that people who need it most will probably contribute least towards it. That is in effect what you are saying. You are saying people who are not taxed in a taxable bracket will gain perhaps as much benefit, if not more

benefit, from some of these programmes as others, people with low salary brackets who are non-taxable. Is that what you are saying?

DR. HOUGHAM: This may be the implication of what I was saying, but I was rather arguing if you do it through a system of wage-related contribution you are asking a segment of the economy to support a programme which is available to everybody.

THE CHAIRMAN: You are saying wage-related contributions should apply to wage-related benefits, but where the benefits are not wage-related, they are more generally made. Wage-related contributions do not apply because they are too narrow.

MR. STUBBINS: Why bother setting up millions of administrative accounts for a benefit that is universal when you can collect it through a much more simple way, through income tax revenue?

COMMISSIONER PERRY: I don't think there is any argument wage-related benefits do not achieve income re-distribution.

DR. HOUGHAM: Unless they are codified.

MR. STUBBINS: Except through internal subsidy.

COMMISSIONER PERRY: Unless you play tricks with it. One of the elements of earmarking which you really do not mention here is that sometimes it is not the taxpayer that has any cause to consider here, but the politician. In other words, it is not always the man on the street who wants these things. We have instance after instance of the political process now

demonstrating quite clearly in the case of old age security if there is an increase in benefits there has to be an increase in the specific charge for this purpose, which may act as some deterrent. It may not be conspicuously acting that way. At least the parallel is there, quite obviously.

THE CHAIRMAN: What evidence is there to support your conclusions in paragraphs 4 and 5 to the effect it is doubtful whether disclosing the cost of programmes is a significant consideration, and the value of achieving this disclosure has to be balanced against the heavier cost of collecting and administration of the programme.

I can accept the second statement all right, but we have heard it said that everything should be done to let taxpayers know the cost of benefits that they are getting from the Government. You say it is a little doubtful whether there is any value in endeavouring to achieve this.

This comes up in the indirect taxation -- is it important to disclose the amount of sales tax at the consumer level? Would you like to amplify your paragraph 4?

MR. STUBBINS: Just a point on that, you can achieve this educational function perhaps the way the City does with Municipal taxes. While they have a general rate, they show in the bill so much percent is for fire and so much for this and so much for that. The taxpayer really sees how the Municipal tax dollar is broken up.

I imagine this sort of thing could be achieved through income tax without having specifically earmarked accounts and without all the heavy administration costs.

In other words, showing national defence and so on and what the different programmes cost as a percent, and you can achieve this objective in showing your distribution.

THE CHAIRMAN: Would that be a good thing to do? You say it is doubtful whether that is a useful thing.

MR. STUBBINS: That is in contrast to setting up separate accounts.

THE CHAIRMAN: All right, accepting your amendment to my thought of setting up separate accounts, would it be useful to send out a statement to every citizen showing where their money is going? I am asking you whether it serves any advantage psychologically or practically or any way you like to put this? I think you cast doubt on the idea here.

DR. HOUGHAM: I can only speak personally on this. I do not think the Council has a position on it. My own position would be it would not accomplish much.

If you are talking about a break-out of Federal expenditure and interpretation to the citizen, how are you going to break it out? If you break it out on this kind of level, it might have some kind of impact, but you end up presenting the citizen with a document that looks like the Federal Budget. If you

are going to do it on a broad basis, national defence, social welfare, agriculture, what does this really help?

THE CHAIRMAN: I don't think very much.

COMMISSIONER PERRY: I am afraid in all this you have not told us what the criteria should be for determining whether the country should be developed on an income re-distribution basis or contribution related basis, and this is the ultimate dilemma. Fortunately not one that faces this Commission particularly, although in a sense it really leads one to the task as to whether the general tax system should be used or whether specific contributions should be used.

DR. HOUGHAM: I think one could make one generalization that is obvious, and that is at least there is an argument for using wage-related contributions where the conditions you are talking about are related to the condition of employment. We do it with Workmen's Compensation and insurance.

MR. STUBBINS: It is easier to draw lines in terms of policy as between what programmes should be means-tested as against which should be either social insurance or straight cash payments. I think that is easier to draw. It is a contingency that affects many people, whether it would be impractical and unwise to force that on an individual means-test, but when you get to the matter of administration policy as to whether it should be cash payments for everybody or a wage-related programme --

THE CHAIRMAN: It was drawn to our attention

that three per cent of corporation income which is used to partly finance old age security was badly placed because it should really be imposed on employers of all kinds, whether they be corporations, partnerships or whatever, or whether they make a profit or don't make a profit. Is that what you are talking about? In part I suppose it is.

MR. STUBBINS: You mean whether the entire cost should be borne by employers?

THE CHAIRMAN: No, not the entire cost; three per cent. It is badly placed on corporations because profits of corporations are only one segment of employers, and really they felt this should be spread against all employers.

DR. HOUGHAM: I have heard this argument too. I don't think the Council as an organization is competent enough in economic areas to make a suggestion on it.

COMMISSIONER PERRY: About the Federal Social Security Programme, it has really been a shotgun approach. They simply used their general revenue sources and made a mass of general payments on the basic assumption that if you have enough money churning around it is going to help the economy. There has not been any very precise judgment as to social objectives I am quite sure.

D.R HOUGHAM: To help the individual who needs the money.

COMMISSIONER PERRY: It serves both purposes, although I imagine it was an economic stimulus. Perhaps it could be argued this is all the Federal Government

should be trying to do, to provide a more favourable economic background.

DR. HOUGHAM: I think broadly speaking the Council has taken a position over the years in relation to these programmes with some reservations, but broadly speaking that the Federal role is more effective in the mass programmes where you need to get into accurate tests of need, and this kind of thing, and in most cases you need Provincial and/or Municipal administration.

MR. BAETZ: There is perhaps one question that has not been answered about this type of programme, this universal assistance, and that is that it may encourage people to stay in economically marginal areas when perhaps they should be moving out. I think this is a question mark which has been raised quite frequently.

We give them just enough to rather encourage them to stay where they are, when in fact if they were withdrawn and were encouraged and perhaps financially assisted to get out of these chronic economically depressed areas, this would be the best way.

THE CHAIRMAN: I think the best way is to cut them off.

DR. HOUGHAM: I must register a dissent on this. It would seem to me in terms of social justice you can't do it this way. You continue payments, and the way you solve the problem of depressed areas, with incentives and so on, and I would think this applies just as much to the problem of locating industries

as people.

MR. BAETZ: I think the Chairman was being facetious there.

DR. HOUGHAM: I was just conscious that it was going on the record.

COMMISSIONER WALLS: In the current programme of movement of people from rural to urban areas, and of course they are going off farms at the rate of about 20,000 a year in Canada, and there is not much of a problem really in regard to the young people because through vocational training you can get them adjusted, but when the average age of all farmers in Canada is up in the fifties, you do have a problem then of whether you have to find some means of assistance.

MR. ALEXANDOR: Perhaps the resistance the Chairman suggests comes from these people who are just as well off to stay where they are. With old age pensions it more than adequately meets their needs.

COMMISSIONER WALLS: It is the environment they are used to, and you can understand it. When you get to that age you are not ready to be moved.

DR. HOUGHAM: This is a dilemma which applies not only to your mass income re-distribution programme; it applies equally to your tax system because your basic exemptions are more variable if you look to people in areas where the cost of living is low than where it is high.

THE CHAIRMAN: I was going to come to that when you deal with exemptions. I was wondering if you had anything more you wanted to say about variable

exemptions than what we have heard.

COMMISSIONER PERRY: There is the more serious charge that some of the younger economists are making now that stablizing programmes may be militating against economic growth in the sense that they do make tolerable continuation of present trends, which, under a really sharp change, would be eliminated to the advantage of the economy.

They have now slurred over and blurred over the sharp biting sort of changes which sometimes produce a further substantial upward movement. I think perhaps this is more serious in the effect on the individual, and this charge has not yet been substantiated I don't think.

COMMISSIONER WALLS: That comes right back into the field of both subsidies and tariffs.

COMMISSIONER PERRY: A lot of other things are doing the same thing there is no doubt, but so far the social welfare scheme seems to have been doing it most successfully.

DR. HOUGHAM: I would agree with both of these remarks, although what I was arguing is that our society has advanced sufficiently far in the area of social justice that I do not think the community would accept using the kind of cutting edge that would be involved if you simply eliminated benefits where you wanted people to get out into an area where they didn't need benefits.

THE CHAIRMAN: So I think apart from social aspects of it, we cannot have stability in our economy

without paying the cost of it, and by the very nature of stability, must limit growth --

DR. HOUGHAM: The problem is to have stability without rigidity.

COMMISSIONER PERRY: We have the kind of economy we wanted a few years ago, and we still don't seem to like it.

THE CHAIRMAN: You speak about taxation benefits at the bottom of Page 22. I was curious as to how far you would go. I think you endorse the taxation benefit as it is now carried out, and probably you extend it to family allowances. I think that is what I read. Then you would extend it to unemployment insurance, disability pensions, public assistanc we will say. If anybody became taxable under that heading, I suppose you might include it. You do at some point make a distinction, or point out that there is a philosophical distinction as between what might be taxed and what might not. There are two schools of thought I think is what you say.

How far would you extend this taxation and why?

DR. HOUGHAM: I have the impression, and it goes back to the question that Mrs. Milne raised at the beginning as to the testing, if you like, across the country. This was an issue in which people broadly in the social welfare field were not at all in agreement. I do not think I can say much more than we have said here.

Speaking personally, and I think in another

place in the brief we do enunciate this principle, we argue the total amount of income rather than the source of it should be the important consideration, but how you apply that principle without getting down to the level of individual benefits under various social security programmes is a much more debateable question.

COMMISSIONER WALLS: Under No. 3, you say "The direct use of the tax system, through the special $500.00 exemption for the aged, the blind and the disabled, to achieve a social welfare goal is more questionable."

Now, it seems there are two thoughts here. First of all, your sub-paragraph afterwards rather intimated that it is paying an equal benefit to somebody who doesnot actually need it as to the needy, but the footnote that goes with it rather intimates that this tax exemption should be extended beyond the blind and the disabled to anybody else who is unable to carry out a gainful occupation.

You don't put that in your brief, but that is in the footnote. Now, which is the principal idea that you are putting over here?

DR. HOUGHAM: I think, Mr. Walls, the principal idea of the footnote is that if we are going to continue this as a social policy, then it is rather difficult to understand restricting it to the present group.

COMMISSIONER WALLS: The provident man in the medium salary bracket who has saved for his old age, is he not just as much entitled to this as the man who

made no attempt, knowing at the end of the road the state would look after him? He isn't just as much enttitled to this benefit?

THE CHAIRMAN: They have eliminated both. They say there is no justification for these benefits.

DR. HOUGHAM: That is correct.

THE CHAIRMAN: We had before us rehabilitation people who were pointing out there were lots of costs incurred by these people in order that they might carry out normal activities of living, which costs are not common to all, and therefore they should be deductible.

We suggest that as a corollary of that this special $500.00 should not be granted, that there is no support for the $500.00 as far as we could see if they were going to be permitted to deduct everything else, and I think they agreed to that. I think perhaps the $500.00 here now in the Act for the aged, blind and disabled -- I think you suggested somewhere it was the higher costs they would incur. Is that the justification for that $500.00?

DR. HOUGHAM: I don't know what the reason was for putting it in the Income Tax Act. I think we had assumed that the objective was a social welfare objective. Our argument was that a more effective and equitable way of doing this is through social security.

THE CHAIRMAN: I have never seen any justification for old age deduction. My own experience has been older people are not generally spending the

same amount of income as younger people.

COMMISSIONER WALLS: Only one might be justified, one that has been placed before us, the exemption of drugs from sales tax. It is claimed that old people spend a much larger proportion of their income on drugs than younger people do, and perhaps this is an alternative by giving exemption on drugs.

THE CHAIRMAN: I gather you do not endeavour to support either of these deductions in the Act?

DR. HOUGHAM: No.

COMMISSIONER PERRY: There is another practical reason: that prevents a good many people from being taxpayers for the first time in their lives. There must be quite a few people in the small towns who, with old age pensions, find themselves in a taxable bracket or they would without this exemption probably for the first time in their lives, and they might quite rightly draw some uncharitable conclusions about the kind of country they are living in.

DR. HOUGHAM: I might say, Mr. Chairman, if I might, I have the impression that some people in the social welfare field are not completely easy about this proposal we are making here because they are looking at it in terms of the needs of the aged, especially those in the low-income brackets, and they are concerned that any step which reduces their income, increases the problems of these people.

In other words, to put it in the vernacular, they prefer a bird in the hand to two in the bush. We say eliminate it, and if there is need, increase

the benefit, and they say they have this kind of benefit now.

THE CHAIRMAN: We have had representations from associations of pensioners suggesting that $500.00 be increased. The support for that was really on the basis of the needs of the older people, I think as you explained, Mr. Walls, but I have thought that a great many of their constituents would not be taxable whatsoever, although when one adds old age security, they might become slightly taxable.

COMMISSIONER PERRY: This will be $900.00 a year next year, and with the basic exemption of $1,000.00, there wouldn't have to be much other income to make them taxable.

THE CHAIRMAN: You don't come down on this distinction at the top of Page 25 as between pensions for lost income and really the benefit of insurance proceeds. I think you have explained that by saying that it is pretty hard to get agreement on that.

At the bottom of Page 25 we come to non-governmental employee benefit programmes, Item No. 1 -- I am not sure that I am very clear of what you speak there. The second sentence, "the benefits are in fact a form of deferred income and should be, as already indicated, liable to income tax".

I suppose the only point there is when they should be liable to income tax, and if and when one defers income, the amount of benefit is not necessarily the same amount of dollars as it would have been had it not been deferred. That is future value as well as

present value.

DR. HOUGHAM: We refer to it somewhere else in the brief, at least where the contribution is not taxed, deferred benefit should be. We do acknowledge also that this means a different tax rate, depending on the income at the time, total income at the time of the tax.

THE CHAIRMAN: Have you given any thought to how far you would carry this? We have had professional athletes associations before us suggesting that their period of earnings are very short and it should be possible to defer some of these earnings over a lifetime. In other words, a pension plan or pension arrangement should be made to operate at age 40, something of that kind, for those particular people. Does that appear to you as being socially just?

DR. HOUGHAM: My question is, Mr. Chairman, is it socially desirable?

COMMISSIONER PERRY: I can't quite make up my mind whether you have reservations about the way in which non-governmental employee benefits are now treated or not. You say that the benefits should be taxed. Does this mean you are satisfied with the present treatment which ensures that they are taxed ultimately, or do you feel they should be taxed immediately?

DR. HOUGHAM: This is a question that our Committee just did not deal with. They didn't wrestle with it.

COMMISSIONER WALLS: You deal with it in different places in a different manner. When you deal

with provincial hospitalization funds I rather judged that there was a feeling that the tax should be on the premium rather than on whatever payment happened to be made out for actual hospitalization. Am I not correct that that is in your brief also?

THE CHAIRMAN: We are coming to that.

COMMISSIONER WALLS: They are sort of inconsistent. If you are going to delay payment of income tax, then you probably have to in regard to such things as hospitalization.

COMMISSIONER PERRY: The pensions position I think is largely just the result of the practical position of a wage earner. This is the largest deduction he has made from his wages. It is the largest contribution that is made by his employer, apart from his wages, and you ask him to pay tax on an amount which he has paid in himself, and in addition, an amount which his employer has paid in on his behalf. I think this creates a very serious practical financial problem for him in most cases.

THE CHAIRMAN: I gather you arein favour of deferring tax on this providing the manner in which it is done conforms to socially acceptable practice as referred to at the bottom of Page 26 under (a) and (b), am I correct?

MR. HOUGHAM: I think, Mr. Chairman, the position the Council has taken on other statements on social security --

MR. STUBBINS: The very fact the present system was not challanged, I think that would imply acceptance of the present position.

COMMISSIONER PERRY: I find it a little difficult to understand paragraph 1 on page 25:

"The benefits are, in fact, a form of deferred income and should be, as already indicated, liable to income tax."

If in the majority of cases they are then we read this as simply approving the present treatment.

THE CHAIRMAN: I had the same difficulty when I read it last night.

COMMISSIONER PERRY: It implies some change should be made.

MR. HOUGHAM: Part of the reason we got into this relates to the next paragraph where we wanted to relate this back to taxation of benefits under public programs.

THE CHAIRMAN: I see. I am interested in your suggestion at the bottom of page 26. You come up with a practical manner by which the alleged constitutional difficulty can be overcome.

COMMISSIONER PERRY: No doubt this is all a very mixed bag at the present time and we are going to have to make up our minds about it.

THE CHAIRMAN: Yes, somebody has to make up their minds about one or two other things in

the area before we do. It is not far off. You think a percentage limit is a better limit than a dollar limit, I notice at the top of page 27. There is certainly merit in what you say. Certainly the percentage limit would have to be restricted.

MR. HOUGHAM: A percentage limit up to a maximum, I would assume.

MR. STUBBINS: We suggest we would look at what social policy we are after.

THE CHAIRMAN: If you put no positive limit on it it seems to me it ceases to have any social attribute whatsoever and becomes just a scheme to reduce taxes. Now I will go on to Taxation and Charitable Donations.

COMMISSIONER PERRY: We passed over the strong statements about the requirements for setting up standards for approval of private pension plans.

THE CHAIRMAN: We referred to (a) and (b). I said I was glad to see they overcame the constitutional difficulties.

COMMISSIONER PERRY: I see other difficulties than that. I cannot see why you feel so strongly about this to begin with. I suppose what you are arguing is there was more strict supervision at one time and it is unfortunate that there has been relaxation and you want to go back.

MR. HOUGHAM: I don't think we want to minimize the practical difficulties in this area which Mr. Perry is referring to. It is simply a

question of statement of principle. How you apply it in practice is something else. Remember we are working the same as in the area of charitable donations. If you are going to provide a tax concession you have to provide some way of protecting the public interest.

COMMISSIONER PERRY: Quite true. All that is involved here really as far as income tax is concerned is whether this is a legitimate cost of the business and it needs a good deal less defining than you suggest here to satisfy them.

MR. HOUGHAM: This would not apply at the level of employee contribution.

COMMISSIONER PERRY: That is true but if the plan meets the general test as not being abused for the benefit of a few people in the firm --

MR. HOUGHAM: Then you are getting into the area of the standards.

COMMISSIONER PERRY: You don't need all these kind of standards for adequate actuarial supervision. The plan could be going broke and the contribution would be a valid deduction for tax purposes.

THE CHAIRMAN: Their propostion is, I think, if it is to be used as a deferment of tax for social purposes that it should satisfy the appropriate social test and one of those tests is it should be a plan which is going to be able to accomplish what it sets out to do.

MR. HOUGHAM: In the terms of actuarial

supervision that is what we had in mind.

COMMISSIONER PERRY: I don't disagree that these are all sound objectives.

COMMISSIONER WALLS: You are just a cold blooded tax collector!

COMMISSIONER PERRY: I labour under the illusion this is a tax commission.

THE CHAIRMAN: Taxation of Charitable Donations -- what restriction should there be to keep it within limits of being charitable? You have an idea that there might be a referee introduced into it. Is that correct? Or was that somebody else's point? I think you proposed there should be a committee on Health and Welfare brought in to referee these matters.

MR. HOUGHAM: We talked about an advisory committee.

MR. STUBBINS: We didn't get a concensus of the number of points of view expressed. There were extreme positions represented there. I think this represents the great majority in the middle. Again, there is no consensus of any one of these positions.

COMMISSIONER WALLS: Do you not think it requires a little more definite definition than is in the Act at the present time. I mean, the latter two requirements are quite broad in their implications if it is for education or for public benefit. That is where you run into a grey area of what is a true charitable organization as against organizations which it might be doubted would come within that classification.

MR. HOUGHAM: Our Committee wrestled with the question of the definition at some length. There were two broad problems involved. There is the straight question of fraud, which is always a problem, but beyond this you get into the problem of a definition and we certainly did not have enough wisdom within the Committee. We felt there was a need for better definition but we did not have enough wisdom to come up with one. It is very difficult to define what is education and what is propaganda when you get into some of the voluntary organizations. I don't know how you can discuss this without getting into cases and when you get into cases what is one man man's meat is another man's poison.

COMMISSIONER WALLS: Would you have any objection to what has been discussed considerably before this Commission and that is ministerial decision in these cases?

MR. HOUGHAM: If you mean by "ministerial decision" discretion, well, ministerial discretion presumably is exercise in relation to some sort of a definition and I don't think you solve the problem unless there is no appeal in which case, you make it arbitrary.

MR. ALEXANDOR: There is a certain amount now.

COMMSISSIONER WALLS: It is not closely enough defined. Would yourassociation be prepared to give the Minister closer guidance? Apparently you find it difficult yourselves right now

to make a hard and fast definition that could go into an Act. If you are not going to do that it seems to me you have to rely on somebody's discretion, whether a Committee you set up yourselves and get the Government to agree to accept it, or the Minister accepts it. If you do that you will have to aid him somewhat in a definition.

THE CHAIRMAN: If you want to operate you have to have a set of rules.

MR. HOUGHAM: Unless you follow a procedural approach which is one of the alternatives identified, the essence of which in my judgment is that you try to divide effective procedures by which the public can make a more intelligent judgment than they may now be able to give.

THE CHAIRMAN: I am not sure that is the job of the Government. There are other agencies who can do this sort of thing and in fact there are now some operating in Canada for that purpose. I think Government's job is merely to decide what is a fair deduction from income and in doing so has tomake up its mind the sort of thing it wishes to encourage by a deduction.

I think it has something else to do and that is to see these privileges are not abused and I would suggest the way that might be done is to certify those organizations, whatever they may be, and to withdraw that certification if receipts are issued falsely or in fraud.

MR. ALEXANDOR: We go further than

that under the present system. There is a form of application an organization uses which asks the organization to set out what its purposes and objects are. It doesn't require them to note the kind of supervision we talk about on page 29. For instance, whether they have their books audited, how many meetings they hold in the year and this sort of thing.

COMMISSIONER WALLS: There is another question you have not brought up there which we have put before us quite a bit. That is when, in order to raise funds, a welfare organization or charitable organization earns income in a manner that is in competition with other tax ~~paying~~ corporations doing business.

THE CHAIRMAN: One catch might be they are not in business. I think that is what you had in mind.

COMMISSIONER WALLS: That is one solution of it. Opponents of the practice have been quite strong and quite outspoken about it. I think you realize that many fund raising organizations embark on ventures in direct competition with legitimate business having to pay taxes.

MR. BOETZ: If you take a specific example I think you begin to realize how extremely difficult this would be. What about blood banks? The Red Cross in this country has a free blood transfusion service and in many countries these are commercial organizations.

COMMISSIONER WALLS: We have churches going into the catering and in the United States they

have made an amendment to their act that if they provide any of these facilities for non-members then that percentage of the business will be now taxable.

MR. STUBBINS: We have excluded all reference to churches or any other organizations termed charitable in the Income Tax Act. We are restricted to the social and welfare groups. I don't think there is much of that kind of fund raising.

THE CHAIRMAN: I was trying to think in regard to the welfare field. I think there is perhaps a bit. I can't remember what it is right now.

COMMISSIONER WALLS: What about the work of the Salvation Army in selling of clothing? Is that not in competition? I am not disagreeing with it but where do you draw the line? Do not some of your other organizations put on rummage sales?

MR. STUBBINS: This would represent a very small part of their income. I think the organizations we are thinking of would be getting income from an annual appeal and fees for services. The services they provide are generally not in competition with anybody else.

THE CHAIRMAN: How about sheltered workshops? I don't think they are damaging to competitors to any extent. There may be areas that they will hit on something that will cause disruption in the nornal avenues of trade. We haven't heard very much about that. The restaurant people complaining about the selling of meals and drinks is what we have heard mostly about.

MR. ALEXANDOR: The way to get after those people is through the municipalities. The municipalities give a tax exemption on real estate to charitable organizations providing they are not using the premises for renting out a hall to an outside organization catering or selling meals. Once they do that they lose the advantage of the tax exemption.

MR. STUBBINS: They are in the field that is not competition. I am thinking of the adult retarded workshops. It is the type of work most commercial organizations would not be interested in. They would be doing map sorting or something like that.

THE CHAIRMAN: I think from a practical point of view it is not much of a consideration. I think the main consideration is meals and drink and there is a real concern. There are restaurants which claim they are being quite badly hurt by it. I don't think that there is much in the way of welfare organizations competing.

COMMISSIONER WALLS: I would not want to be in the broom business! I notice that one of the requirements is that the organization operate from a detailed annual budget which shows program plans in financial terms. I just wondered if it is an organization entirely reliant on public subscription, how accurate a budget is it possible for that type of organization to ever draw?

MR. BOETZ: I would think in most of these cases they established their budget before the program year begins and they have had advice as to

what they might realistically hope to get by way of voluntary income and the budget is established on that basis.

THE CHAIRMAN: I think they have a budget of a kind but I suspect it is not a detailed annual budget which shows program plans in financial terms.

MR. BOETZ: This varies and Mr. Stubbins can talk about agencies.

MR. STUBBINS: They have an intent to deliver a certain program in the following year. They all have a plan and they express themselves in a budget in financial terms. In a sense this is now demonstrated in the T5-11 form. One of the considerations required is that an organization is able to pay its bills. They take a measure of financial stability. I think this is now being done to make sure it is not a fly-by-night organization that is going to pass through with a bunch of unpaid debts.

THE CHAIRMAN: I am only complaining about your term here "Program plans in financial terms." That means costing out the different items in the program.

MR. STUBBINS: The intent was not an elaborate cost accounting forecast.

THE CHAIRMAN: I am sure every organization has a budget of some kind. It may be very rough indeed.

MR. HOUGHAM: This particular section is directed to the people in the social welfare field.

It is an objective to which we are striving, to get a more effective program budget.

MR. STUBBINS: Get the budget related to the volume and type of service.

COMMISSIONER WALLS: In the T5-11 form right now you have to give a budget of your expected expenses, your salaries, your travelling expenses, your publicity, your office expenses, andother expenses, and the total.

THE CHAIRMAN: I have got to Taxation and Medical Expenses. Is there anything before that?

COMMISSIONER WALLS: I notice that you make mention of union dues. Do you consider that union dues are a justifiable deduction, a charitable deduction, or have you any opinion on it?

MR. HOUGHAM: We would have no opinion on it. I think we took the position that to lump together union dues and medical expenses with a voluntary contribution was, to put it at the best, illogical. These are in the category of unavoidable expenses. Contributions are within the judgment of the individual. They are in an area of voluntary giving.

COMMISSIONER WALLS: You also question a matter that has come up before the Commission two or three times. That is the difficulty of some international charities being acceptable. You would place them, I take it, under the same criteria that you wished to put on for the domestic ones?

MR. HOUGHAM: Yes, I think we would.

My understanding of the problem in this area is it is the way the regulations themselves are framed which allows a number of organizations operating welfare programs, broadly speaking in the international field, to qualify, and others who are operating substantially the same kind of programs to disqualify.

THE CHAIRMAN: The words "in Canada" appear in the section but it is not known whether it means the money must be ultimately spent in Canada or not.

MR. ALEXANDOR: The Department doesn't seem to enquire into that too closely.

THE CHAIRMAN: Some permit donations to some Canadian organization for the benefit of non-Canadian organizations although, I believe, that is not done universally.

COMMISSIONER WALLS: I think they do it for the Unitarian movement but not UNICEF.

MR. HOUGHAM: That is right. That is a good example.

MR. BOETZ: During the World Refugee Year, which had the official endorsement of the Governor general and the Lieutenent Governors in the provinces of the country this organization, of which I was the Chairman at that time, had the greatest difficulty in getting a decision on this particular thing.

THE CHAIRMAN: Did you get one?

MR. BOETZ: We eventually did. It required almost four months of the year before we finally got it.

THE CHAIRMAN: I would refer to the standard deduction on page 31.

COMMISSIONER PERRY: I am just wondering in what way you thought increasing automation in the processing of tax returns would bear on this particular deduction. As I understand it, the problem was that returns were coming in with great wads of receipts attached to them -- as my own return goes in -- and that these receipts had to be processed and filed.

DOCTOR. HOUGHAM: We may be off base on this. I refer also to the clause that follows. It is my understanding in the American Tax Administration they do not do a detailed review. They do some kind of sampling review on these claims, and they claim at least they get just as good and as honest a return. If they find a person cheating -- I don't know any other word -- when they so sample and check, they hit them particularly hard.

THE CHAIRMAN: They have a rather large standard deduction.

COMMISSIONER PERRY: I don't think it is a system that should be in the country.

DR. HOUGHAM: I had assumed it was not until you made the comment they had to go through all the receipts.

COMMISSIONER PERRY: I imagine when a lot of receipts are submitted that they are audited.

THE CHAIRMAN: You make the point very clearly that a standard deduction works against the purpose of the deduction, because if one is going to get the same amount whether he gives or does not

give, he is not so likely to give.

DR. HOUGHAM: It is a subsidy to the non-giver.

THE CHAIRMAN: We have representation as to the need to increase this 10 percent, particularly because of education. Do you happen to know what proportion of the donations in Canada are for educational purposes? It is quite large, I think.

DR. HOUGHAM: Certainly a growing proportion, and it is a very large proportion.

MR. ALEXANDOR: I think the Canadian Universities Foundation gave that to this Commission.

THE CHAIRMAN: As a matter of fact, the reason I asked that is that the thought I had in mind is perhaps of the 10 percent now permitted, 5 percent could be delegated to religious and also welfare matters, and the other 5 percent for educational purposes might be increased to 10 percent, so that the welfare and religious side would in fact be reduced, but I would be very surprised if that would affect welfare because I don't think there would be many people contributing more than 5 percent to welfare and religion together, but I may be wrong.

MR. ALEXANDOR: Building programmes of the universities are caught in these demands.

MR. STUBBINS: The average claim is of course a very small fraction of 10 percent. 1 percent or 1.1 or maybe 1.3 for individuals.

DR. HOUGHAM: I think we made it clear in relation to the welfare field rather than other

fields, although I think the comments we made on (a), (b) and (c) on page 32 would apply to other fields as well as welfare. It is a question of how you want to accomplish what may be a desirable social goal in increasing university building or whatever.

MR. STUBBINS: I think one of the points we made was that we do not really get a very detailed breakdown now of the distribution of the dollar through the tax return. There is very limited information available, and we suggest there could be consideration given to providing more comprehensive statistics on how much, for example, goes to religion.

THE CHAIRMAN: Yes, I see you so recommend.

MR. STUBBINS: We get very little now.

MR. ALEXANDOR: It was the Canadian Conference on the Arts that gave an estimate. Health, Welfare and Educational institutions received the majority of all donations made. Regarding corporations, total donations are estimated to be 1.4 percent of taxable income.

THE CHAIRMAN: That comes from the Conference on the Arts?

MR. ALEXANDOR: They complain all they get is .03 percent of it.

COMMISSIONER PERRY: The real problem with the statistical information is that the

Department uses all the columns on its I.B.M. machines, and if it gets any more information here, something else has to go.

THE CHAIRMAN: Now, I have come to taxation and medical expenses. Is there anything before that? In a general way I think you agree with the present practice. You suggest, however, that the 3 percent floor should be looked at pretty carefully.

At such time as our national health programme is resolved, it may be necessary to make changes. I thought your recommendation with regard to practical nurses and visiting homemakers might be rather difficult of application. You suggest that a doctor should certify. That puts the doctor in a rather difficult position I think, and they might resist being called upon to give such a certificate.

MR. BAETZ: In the case of the visiting homemaker, this would not present any great practical difficulty because in Ontario particularly the homemaker is now partially paid for by the Ontario Department of Welfare, so an application has to be made so that this information is available.

MR. STUBBINS: You are dealing with a recognized agency of some stature in the community. There could be administrative control. When you get out to practical nurses, it would be more difficult.

DR. HOUGHAM: I think, Mr. Chairman, the bigger dilemna here is that -- and I am arguing against our own brief in a sense -- that some of these services are not only not universally available, but are available in very few communities across the country. Homemakers are a good example.

A necessary service, but is not recognized as sufficiently necessary to have broad availability.

THE CHAIRMAN: I would agree with you that the tax laws should, if possible, be designed to promote homemaking services. It seems to me that is very logical.

MR. STUBBINS: In reference to the difficulty of having the doctor certify; he has to certify whether a patient should stay in the hospital at $30 a day, and it is his word which determines whether the patient is in or out, so that this is not a responsibility that is any greater here to determine whether there is continuation of care needed in the home.

COMMISSIONER WALLS: Rather than going to the doctor in every individual case, couldn't you have practical nurses also registered, as well as nurses registered, and if a person was under that registry, they could be exempt the same as you have for registered nurses.

DR. HOUGHAM: We have been attempting to promote extension of this service and

development of standards in relation to it, but I think it would be fair to say at the moment it is not a profession, and what standards you set up in relation to some kind of certification could be a very desirable objective.

THE CHAIRMAN: I would have thought if we are going to rely on an organisation, there must be standards, and it can only be done at that point.

DR. HOUGHAM: I think, Mr. Chairman, this is why I was ignoring the problem of the pressure it might put on the doctor. We had proposed it might be through a doctor's certificate because here is a professional person making a professional judgment.

THE CHAIRMAN: Yes, I would gather that is probably the only way it can be done.

COMMISSIONER WALLS: At $5 per certificate.

DR. HOUGHAM: I am not so sure about that, Mr. Walls. In a sense it would seem to me there may be some abuse, but broadly speaking, people are not going to be putting pressure on their doctor to get this kind of certificate unless there is a need for it. They have to pay for it.

MR. BAETZ: Lots of times there is not a doctor involved in the case where there is homemaker service. Unfort natel the wife packs up and walks out on her husband.

DR. HOUGHAM: We are talking about the medical aspect of it here.

THE CHAIRMAN: As you point out, it is a deduction, and people are not going to -- people have got to pay for it, which puts a brake on how far it is going to go.

DR. HOUGHAM: I was trying to make the distinction between this and getting a certificate for liquor.

COMMISSIONER WALLS: That is just what was going through my mind.

THE CHAIRMAN: I have now come to family income, exemptions and allowances. I was interested to see that you believe if we use family allowances appropriately, there is no further need for income tax adjustment because of children, which I would think would greatly simplify our tax schedules and the computation of personal income taxes.

DR. HOUGHAM: I think I would agree with you, Mr. Chairman. I think I would enter a more serious reservation about this: Even in the area of old age security along the same grounds, but presumably the old age pensions come somewhere near meeting the average need. I think it is much more questionable whether the family allowance on the level we have it now in any way takes that into account and the differential of costs of different sized families.

If you are going to use the family allowance system in this way, it is going to be a radical transformation of the family allowance.

THE CHAIRMAN: I was taking it you meant at some low level of taxable income for a family one might work out tax deductions that are presently being achieved in respect of children eligible for family allowances and take tax deductions and add them to family allowances.

Would that be what you are proposing?

DR. HOUGHAM: I don't think it is what we are proposing.

COMMISSIONER WALLS: You then result in taxing lower income brackets than are affected today. If you take off exemptions and make them entirely on the basis of family allowance, then you would be taxing lower income tax brackets than are taxed today.

DR. HOUGHAM: That is true, and the important phrase is 4(b) on page 37, "To the extent that family allowances are adjusted to take full account of the social contingency, the exemption should be eliminated or it should be set exclusively on grounds of convenience."

COMMISSIONER PERRY: I read that simply as meaning if there are increases in family allowances, some adjustment of the income tax allowance should not go unnoticed.

DR. HOUGHAM: It could be argued that way, but going to the extreme of family

allowances, saying the tax system entirely is to take care of social contingencies, it means a radical transformation of family allowances.

COMMISSIONER PERRY: It would about double their costs, would it not?

DR. HOUGHAM: If I may try to be clear: Do I understand that this is the question of a tax credit?

THE CHAIRMAN: No. I was simply putting the whole burden on family allowances rather than income tax deductions, and it would seem to me that the nation would come out ahead because to the extent that dependent children deductions are taken by people who have above average income, and there would be a saving to the nation , because you only put in the family allowances what is necessary.

Whether that would be offset by bringing up lower ones, I don't know.

COMMISSIONER PERRY: We would lose about 10 to 1 on that deal.

THE CHAIRMAN: It depends on what you bring them up to, and what I started by saying was that you would take the lower scale, and you would adjust at the lower scale because you would achieve for those people exactly what they are now getting.

COMMISSIONER PERRY: This is just leaving their position even. What you are doing is greatly increasing the allowances that you are

paying to people who are not taxable where there is no recovery at all, and I think this would be at least half of the people who are now taxable.

THE CHAIRMAN: The answer is very simple. You simply take the tax reduction which is now brought about by the dependent children's deductions, and add them all up together and take that money and recast the family allowances with a great deal better social justice because you bring up non-taxable people's allowances and bring down taxable people's allowances.

COMMISSIONER PERRY: If you want to make it self-contained, yes.

THE CHAIRMAN: Anyhow, you have not a concrete proposal made to do this?

DR. HOUGHAM: We do have a comment to make. It is more in the area of social security than area of taxation. I am thinking of the earlier comment made by Mr. Perry. But I have heard arguments advanced, and it seems to me there is some validity in them that family allowances should perhaps not start with the first child, because presumably the reason for these allowances is that the wage system does not take into account the differential cost, different sized families, and I think there is a fairly good argument that our system over the years has tended to operate in terms of sort of the average family, and when we get beyond this level, the wage system does not effectively operate.

COMMISSIONER PERRY: This is true of the English scheme, is it not? There is no payment for the first child.

MR. BAETZ: Isn't it true if the wife has been working up until the time of the birth of the first child and is forced to leave the labour market because of the baby, that there is an undue hardship in the family? You think maybe for the first child you could argue that there should be a greater allowance for it?

DR. HOUGHAM: Yes.

COMMISSIONER PERRY: If you sit on a Royal Commission long enough, you realize almost anything could happen.

THE CHAIRMAN: How far would you go with this deduction in respect of education? I see you say, "However, until other public provision is made to cover the cost, it is recommended that expenses (fees) for university education and vocational training of dependents, as well as for adult education and training, professional and technical, should be deductible in computing taxable income."

May I take it the word "fees" limits it to educational fees, and does not include costs of living at the university or other educational establishments?

We have had it put to us that deductions should be permitted in respect of vocational training, I think, and re-training;

not only fees, but also living expenses for that time, and I think it has even been put to us this should be permitted in respect of university education. You don't go that far?

DR. HOUGHAM: Our committee simply did not discuss it any further in relation to fees.

MR. ALEXANDOR: This would depend on the availability of the institution or the teaching centres. It has got to the point now where I suppose 65 or 70 percent of the population of Canada is within a reasonable distance of the university to the point where the student could live at home.

This is not necessarily so of vocational training.

THE CHAIRMAN: Can you tell us whether the cost of schooling for retarded children is soon to become acceptable as the public's responsibility? Is that not done --

MR. STUBBINS: It varies province by province. My guess is it will soon be in Ontario. The Ontario Government now virtually pays for the cost of teachers, but they are not paying other costs.

THE CHAIRMAN: Are there any other social deductions from income for tax purposes, which we have overlooked? Those which we have not yet discussed? That point which taxation should commence, you have not expressed any views on that.

DR. HOUGHAM: I think we have in this final section. I don't think we have expressed views specifically on the amount. It is again a question of identifying some of the relevant circumstances in respect to standard deductions at the bottom of page 36.

THE CHAIRMAN: Mrs. Milne has a question.

COMMISSIONER MILNE: It is rather a broad question. I thought possibly through your membership you might have had something come forward that would deal with the basic amount. I think you mentioned this morning that in the United States studies made on the minimal requirements for a family with two children -- a family of four -- would be $4,000.

I think that the United States Statistics goes on to suggest for an individual living alone it would be $2,000. Also through one of our other groups, possibly the Canadian Manufacturers, in their publication, they suggest that in Canada our living costs are possibly 25 percent below the United States standards.

Now, whether or not that is true, I don't know, but I think the Chairman suggested

to us that the family allowance, let us say a family of four people, $2,000, add on the exemption for children, and add on family allowance which reasonably might be in the age group that would come to $180 a year, and we come to a figure of $2,880, which is approximately $3,000.

What I am really getting at, through your Council have you had representation to suggest that this amount is insufficient, this minimal amount?

DR. HOUGHAM: No, we have not. This question of basic deduction in meetings I held across the country never arose as to whether it was an adequate level. However, I would like to make a couple of other comments, non-welfare comments in connection with this.

One is a obvious one; that it is a question again of how you achieve the social goal. One of the effects, of course, is not just to increase exemptions for those at the margin, but also to increase those in the high income brackets.

I think another important thing that has to be looked at here is what the effect of increasing the exemption is going to be in terms of the total number of taxpayers and the tax take because a lot of the income, as I suggested earlier in this discussion, comes from the low income and below level income groups.

You don't have to cut off many people at this level to cut off a lot of people. That is

a non-welfare remark, as I indicated.

MR. STUBBINS: If it is decided to use exemption as a sort of way of having the minimum non-taxable amount related to subsistence, we are going to have to do an awful lot of work in Canada about what is a minimum standard of living. We have nothing here. No measurement of poverty. We don't have any objective studies.

This $4,000 that was referred to is a very recent one, and it is based on a number of assumptions that may or may not be valid, so this is one of the points we would like to make: We do need this kind of research.

MR. BAETZ: If you are still sitting two years from now, the Canadian Welfare Council will have a study on poverty, and this will give you some of this information.

THE CHAIRMAN: Will you have a poverty line? Will you have an idea of what income is poverty?

MR. BAETZ: I would think at least an attempt will be made to try to do this. It differs from region to region, and I am certain we cannot apply the American poverty line of $4,000 for a family of four. I think there is a great deal of interest in this particular subject, just what is poverty and how much is there.

COMMISSIONER PERRY: I would like to read your report, but I hope as a non-commissioner.

THE CHAIRMAN: On the matter of regional adjustments, I know that you don't say anything about that, and I presume you have not discussed it. We have, of course, across Canada heard that these deductions should be raised for certain parts of Canada where living costs are particularly high, Northern Canada and Newfoundland particularly.

You have not commented on that, and I take it this has not come to you?

COMMISSIONER PERRY: To me the more valid consideration here, it is not a complete exemption from Taxation that we are considering; it is just an exemption from part of the tax system. In effect, all you are deciding is where the progressive part of it will begin to apply. It is awfully hard to think of it in terms of eliminating the subsistance level of income because then you have to start working your way through all the rest of the taxes to achieve the same purpose.

DR. HOUGHAM: Until we have a lot more information than we now have, it is difficult to establish a rationale for making exemptions that in any way relate to social welfare. You would have great difficulty in defending any amount; why this $1,000 or $2,000 for example, or if it were $2,500, why that?

MR. BAETZ: Would there not also have to be a built-in adjustment to reflect the cost of living?

DR. HOUGHAM: An escalator.

COMMISSIONER PERRY: It would have to be year-to-year and region-to-region I would think to be fair.

THE CHAIRMAN: Thank you very much indeed. We have exhausted our questions, and I think we understand the content of your submission fairly well.

This has been extremely helpful to us, I might say, and we are very glad to get it. This is the first time we have really got ourselves into this particular area, and we were looking forward to this and we were not disappointed of course. Thank you, indeed.

We will continue our reflections on this subject for the next several months, I am afraid.

MR. ALEXANDOR: May we thank you, Mr. Chairman, for the interest that you and the lady and gentlemen have taken in our brief. It has given us some things to think about too, and we are gratified to see that it has been sufficiently important to you to engage your attention for the length of time that it did.

I hope we have succeeded in answering most of the questions, although we have obviously ducked some.

THE CHAIRMAN: That is quite understandable.

THE SECRETARY: Mr. Chairman,

We have one brief to enter.

The brief of the Canadian Association of Social Workers, which I enter into the record as Exhibit 282.

That is all, Mr. Chairman.

---EXHIBIT NO. 282: Brief of the Canadian Association of Social Workers.

THE CHAIRMAN: We stand over until 9:30 on Monday morning.

ROYAL COMMISSION

ON

TAXATION

HEARINGS

HELD AT
OTTAWA

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THE ROYAL COMMISSION ON TAXATION

Hearing held in the Centre Court Room, Exchequer Court of Canada, Supreme Court Building, Wellington Street, Ottawa, on Monday, the 9th day of December, 1963.

C O M M I S S I O N

MR. KENNETH LeM. CARTER — CHAIRMAN

MR. J. HARVEY PERRY

MR. A. EMILE BEAUVAIS

MR. DONALD G. GRANT

MRS. S. M. MILNE

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LEGAL COUNSEL

MR. J. L. STEWART

RESEARCH DIRECTOR

PROF. D. G. HARTLE

SECRETARY

MR. G. L. BENNETT

* * * * *

Monday, December 9, 1963.
Ottawa, Ontario.

---Upon resuming at 9:30 o'clock a.m.

SUBMISSION OF CANADIAN FEDERATION OF AGRICULTURE

APPEARANCES:

J.M. Bentley,	President, Canadian Federation of Agriculture.
A.H.K. Musgrave,	President, Ontario Federation of Agriculture.
W.J. Parker,	President and C.F.A. Director, Manitoba Pool Elevators Ltd., past Vice-President of Canadian Federation of Agriculture.
David Kirk,	Executive Secretary, Canadian Federation of Agriculture.
R.H.D. Phillips,	Research Director, Saskatchewan Wheat Pool.
R.A. Stewart,	A Past-President of O.F.A. and C.F.A. Advisor on income tax questions.
Dr. A. Lacasse,	Economist, Canadian Federation of Agriculture.
Lorne Hurd,	Assistant Executive Secretary, C.F.A.
Gordon Blair,	C.F.A. counsel

THE CHAIRMAN: Mr. Secretary how are we getting on for time?

THE SECRETARY: We are right on.

THE CHAIRMAN: We are ready up here.

THE SECRETARY: Mr. Chairman and Commissioners. This morning we have a brief from the Canadian Federation of Agriculture. Associated with this brief is one which was entered into the record as Exhibit 199 on October 7th from the Canadian Cooperative Wheat Producers Limited.

In the delegation this morning there are

members not only of the Canadian Federation of Agriculture but at the same time members of the Canadian Cooperative Wheat Producers Limited who wish to discuss certain aspects of their brief.

Mr. J.M. Bentley, President of the Canadian Federation of Agriculture is here this morning to say a words and will introduce his colleagues to you.

I would like to enter this brief into the record as Exhibit No. 283.

THE CHAIRMAN: Good morning Mr. Bentley and gentlemen. Mr. Bentley, you are leading this delegation, I understand. You are the senior officer of the Canadian Federation of Agriculture.

MR. BENTLEY: I am the President of the Canadian Federation of Agriculture.

THE CHAIRMAN: Thank you. We would be very grateful to you if you would introduce your associates to us and for my part I, will introduce to you the members of this Commission, whose names are before them.

MR. BENTLEY: Thank you, Mr. Chairman, and Members of the Royal Commission. It is a real pleasure for us to have this opportunity to discuss with you some points which you may wish to raise with regard to our brief. I think first of all I should introduce to you the members of our delegation a nd I will start on my extreme right here. Dr. Armand Lacasse, Economist with the Canadian Federation of Agriculture. If you would stand up, Mr. Lacasse. Next to him is Mr. R.H.D. Phillips, Research Director of the Saskatchewan Wheat Pool. Next is Mr. W.J. Parker,

President of the Manitoba Pool Elevators Limited and past Vice-President of the Canadian Federation of Agriculture.

The gentleman who is going to lend some dignity to a farmer's presentation is Gordon Blair.

THE CHAIRMAN: He is over doing it.

MR. BENTLEY: On my left, Mr. David Kirk, Executive Secretary of the Canadian Federation of Agriculture. Mr. R.A. Stewart, Past President of the Ontario Federation of Agriculture and C.F.A. advisor on income tax questions. Next is Mr. A.H.K. Musgrave, President of the Ontario Federation of Agriculture and C.F.A. director and Mr. Lorne Hurd, who is Assistant Executive Secretary of the Canadian Federation of Agriculture in Ottawa.

I think that completes our group. It should be noted, as the Secretary has already intimated to you, that there is also a submission of the Canadian Cooperative Wheat Producers Limited before this Commission at this time with respect to but other than the concept of cooperative taxation.

It has been previously before the Commission in the latter connection with the Cooperative Unions of Canada. W.J. Parker is the spokesman for the delegation for this submission of the three Western Wheat Pools.

The views expressed in this brief result from the policies over the years of the Canadian Federation of Agriculture. Also we have had two extensive discussions on tax questions by the National

Board of Directors of the C.F.A.; a national meeting of representatives of members to review our brief.

Mr. David Kirk, the Executive Secretary of the C.F.A. will be the chief witness for the delegation but the other members of the delegation will make their contribution from time to time and, of course, are available to answer questions which the Commission may wish to direct to them.

Thank you very much.

THE CHAIRMAN: Thank you, Mr. Bentley. Before we move to the tax question, I would like to know a little more about your association.

I see that it represents a great number of organizations which are listed in Appendix A on a regional basis, provincial, I think, would be more accurate.

Do I conclude that these associations are each themselves members of a provincial or regional organization and the regional organizations are members of the Canadian Federation or are all the organizations themselves members of the Canadian Federation?

MR. BENTLEY: No. The way we operate in the main is we have provincial federations for each farm organization. In the provinces the farm organizations are federated in one group. Then the provincial federation is a member of the Canadian Federation of Agriculture.

We have another category where say the United Grain Growers, for instance, have an operation in the three Prairie Provinces and joins as a member in

its own right as does the Dairy Farmers of Canada.

This is another example of that but basically they are members of the provincial federation and then from that, the Provincial Federations are members of the Canadian Federation of Agriculture.

THE CHAIRMAN: So then you have in addition to your provincial members, listed introprovincially, you have a list nationally. Is there any significance to that distinction?

MR. BENTLEY: Not particularly except in the case of the United Grain Growers and the Dairy Farmers of Canada.

These are two national organizations which come in with us right at the national level rather than just through provincial federations.

I should also point out that the United Grain Growers also are members of the Alberta Federation of Agriculture. For instance, they have a right to go into the national and they do.

THE CHAIRMAN: So when you prepare this type of submission, you are guided in it by the representatives of the provincial associations and the national organization who, if they wish to, may revert to their own members but probably do not.

MR. BENTLEY: They would make up national policy and have a right to work through the Canadian Federation of Agriculture.

THE CHAIRMAN: So when you have these discussions, I think you said, at a general meeting or a meeting which the members attend; I presume that

those in attendance were people who came from provincial organizations.

MR. BENTLEY: That is basically true, yes.

THE CHAIRMAN: So that really with the Armstrong Cooperative Egg and Poultry Association, they are a member of the B.C. Federation which in turn is a member of your Federation?

MR. BENTLEY: I think that is right. They are directly a member of the British Columbia Federation of Agriculture and have a right to then be represented by the Federation at the national level.

THE CHAIRMAN: So they would pay their dues to the provincial organization?

MR. BENTLEY: That is right.

THE CHAIRMAN: And the provincial organization, in turn, would pay its dues to you?

MR. BENTLEY: That is correct.

THE CHAIRMAN: I would like to then deal with the profitability of farmers or the economics, the income position of the farmer's income, which is the way you describe it in your submission on page 8, paragraph 26, and I think what precedes that. I was quite surprised to find that the real realized net income per self-employed in the farm labour force increased 10.4 per cent in the period from 1949 to 1962.

10.4 per cent is based on adjusted dollars, I think but in view of the fact that there has been a very great shrinkage in the farm population, I presume that there has been an increase in the average size of

farms during that period.

I think it is rather startling to find that income has only gone up 10.4 per cent. That is, you people say it is startling.

MR. KIRK: That is right. Our point is this.

THE CHAIRMAN: Why is that? We have been going through a period laterally when prices of most commodities have been good.

I think I would have been conscious if prices had not gone up proportionately to other prices so I do not understand why the national income has gone up so much per capita but the farmer's income has gone up so little.

MR. KIRK: Mr. Chairman, the fundamental reason for this is the amount of resources in agriculture, particularly human resources combined with a real increase in productivity in agriculture, which has been very rapid.

It has been said that there has been a chronic tendency to over produce in relation to the market and the economic adjustment that has taken place through a decline in the number of farms and certain other types of adjustments.

For example, perhaps in some cases such as extensive farms of agriculture, like beef production, there are many forms of adjustment but fundamentally the form of adjustment has been a combination of a reduction in the number of persons employed in agriculture plus the restriction through the lack of

returns in exploiting the full potential of production. That is true. I don't think that has been exploited and the process of adjustment as a mechanism is a quite simple economical one. It is one of reduction of returns so as to discourage production and this is the reason returns are low essentially; because it is a process of economic attrition.

THE CHAIRMAN: I can understand over production for the domestic market. That is not a very difficult concept. After all Canada can only consume a certain amount out of a very large production.

You mention a proportion here is exported. What is it, 20 or 25 per cent?

MR. KIRK: Something like that.

THE CHAIRMAN: I would have thought that that would have necessitated a shift into these commodities which can be exported and hence reduce the production of goods for the domestic market and increase the supply of goods for the overseas markets and hence avoid over production. After all we are talking about a long period of time, are we not, between 1949 and 1962, fourteen years.

MR. KIRK: That is right.

The position has been of course, with grain, for example, there has been over a large part of that period, I do not think quite all of it, but the bulk of it a very heavy over-supply of grain for the world market and not only that but there have been measures taken by almost every importing country, in one way or another, to control and limit the import of product into

their countries and quite simply the market has not been unlimited.

Any attempt on our part to have exported increasing quanities or unlimited quantities would have simply seem destructive and the price would not have benefited our income position.

THE CHAIRMAN: Hew about beef? We export a good deal of it, do we not?

MR. KIRK: We export a good deal of beef, yes, to the United States particularly but there has not been an increase in the price of beef to a higher level now than it was at the beginning of that period. Nevertheless, there has been considerable stability on beef prices and I think that it has been one of the products in which the demand is most bouyant.

On the other hand, there has been a shift into increased beef production.

The production of beef animals is not a product into which one shifts easily. It is not like hogs and particularly it is limited by resources of the kind of land adapted to beef. It is a more expensive type of farm agriculture. It takes a lot of capital. It is not an easy transition to make for a producer. It is a slow process.

MR. BENTLEY: Pardon me. May I point out that I think beef prices in North America, that is the United States and Canada, are actually higher than the world prices so the only place to which we can export beef is to the United States. There is really only one market, Canada and the United States. We cannot

export to Europe for instance to compete with the cheap Australian and New Zealand and Argentinian beef. I don't think that is possible. So the North American market is all we really have.

THE CHAIRMAN: I presume that the United States is self-sufficient in beef?

MR. BENTLEY: No, not entirely. If their market is a little higher than ours, beef goes across the line. On the other hand right now there are hogs coming into Canada because our prices are a little better than theirs so there is movement back and forth depending upon who has the higher price level for hogs and cattle.

MR. KIRK: Mr. Chairman, at this time may I point out there is some uneasiness in the United States importation of beef to Canada, just at this particular time. This has taken place recently. Their farmers there are faced with the same kind of consideration as we have outlined with respect to income and from time to time there are some groups who ask questions about the protection of their position, but I think that on the whole it is recognized in both countries the best position to leave the beef industry in is with the North American market.

THE CHAIRMAN: Your position is that the per capita income of farmers is distinctly low, compared to the other people in the Canadian community. Am I right?

MR. KIRK: That is correct.

THE CHAIRMAN: And the correction for that is

generally thought to be larger farms, I believe which is in the main the movement of farm population to urban centres, which has been proceeding for quite a long time. I rather gained the impression that that is what the farmers like as a way of increasing the per capita income. Am I right?

MR. KIRK: They do not think it is uniform. One of the major questions is precisely the question of whether to depend upon this process of adjustment, economic attrition and adjustment as a solution.

There are two things farmers do not like about this. One is that it is painful and they feel unjust, I think, for that very reason. The second is they do not know how long it is going to go on. There is no end in sight.

One of the major questions is whether there should be intervention in the process through some form or type of price marketing, planning and control which may be the right direction to take to get away from this continued economic attrition.

MR. PARKER: That is not entirely true in Canada. It is true in most of the other western countries proportionately.

Traditionally the fact is that the urban areas are gradually replenished from the rural.

THE CHAIRMAN: I think so.

COMMISSIONER WALLS: That is where they get the smartest people.

MR. PARKER: I did not want to put it that way necessarily.

Many farmers are attempting to level up their income by having their wives or members of their families working at other duties such as nursing or school teaching.

I think we have noted this on page 6 here. It is an increasingly important fact in establishing this, not farm income, but what we call inherent income.

THE CHAIRMAN: Of course, this is true of the whole population, I think. I don't know whether it is more true of farmers than other people. I wouldn't imagine so because there is increased participation in the labour force by married women. It is going up all the time as a percentage.

MR. KIRK: I am delighted to hear you say that. In the continuing discussion of farm income it is said the position as we have presented it here is misrepresented because of that fact, which is a real fact, of course. As you point out farmers are not the only ones who have this.

THE CHAIRMAN: It is partly economic and partially social, I think. I believe the average matrimonial age has decreased which has tended to cause younger female married people to work.

MR. BLAIR: If I could offer a non-legal opinion, one of the differences is in the farming community it is the farmer himself who does the moonlighting. In the parts of the country I know you find large sections where no person is regularly engaged full time in farming. The men are out at other jobs and

maybe members of their families and their wives are also.

THE CHAIRMAN: You have some statistics with regard to this in the submission.

MR. BLAIR: Yes.

THE CHAIRMAN: I think it is on page 6.

MR. KIRK: Seventeen.

THE CHAIRMAN: Seventeen, is it?

MR. KIRK: Page 6.

THE CHAIRMAN: Page 6, paragraph 17. It shows that something like one-quarter of the farmers are doing something else.

MR. KIRK: For more than forty-eight days, but by no means all the year.

THE CHAIRMAN: That sounds like a lot, one out of four farmers spending forty-eight days off farm work.

COMMISSIONER WALLS: Is it not a fact 120,000 of your 480,000 are non-commercial farmers earning less than $1,200.00 so they would force that percentage to go up.

MR. KIRK: There are a great many units in the consensus figure of the number of farms that in farming terms are very small.

THE CHAIRMAN: Are these $1200.00 professional farmers for the most part -- semi-professional?

MR. KIRK: They are classified in the concenus as non-commercial, as non-commercial.

THE CHAIRMAN: That means a person with a job in a factory who has a few acres.

MR. KIRK: No, it doesn't mean that. It means

— the definition comes solely from the income of the sales not from the actual fact of the work. It is evident from the study of statistics that there must be a good many of those who in fact are exclusively engaged in farming. I mean a comparison of various statistics -- I forget precisely how it goes, but to tell you the truth, I have done this and find there is some you can't precisely put in this non-commercial category, but if you took only the real farmers the data wouldn't make sense.

COMMISSIONER GRANT: Will you have any comment to make on the accuracy of this definition that has been followed in taking the census through the years? How long has that definition been in existence and is there any need for changing that in your opinion?

MR. KIRK: This is a difficult question. Of course it has been discussed by our people. From the strict point of view of defining farmers who are significant in the business of farming, then, of course it is the wrong definition. This isn't the only purpose of the census. The purpose of the census is to describe the situation of the economy. If you define the farming in terms of too large a size then you eliminate a whole range of activity in existence. This is a problem in the census. It defines sales This is one of the problems. There was a change in the definition last year. What was that -- I have forgotten.

COMMISSIONER WALLS: Was it four acres with

$250.00?

MR. KIRK: It changed the definition so that you had to have, at least, $250.00 worth of sales to be a farmer even if you had more than three acres. Before that if you had more than three acres you were a farmer. Just that requirement, that change, eliminated 40,000 farmers. That means there were 40,000 with more than three acres and less than $250.00 worth of sales. That is a large body of people.

THE CHAIRMAN: Thank you. I used to be one of those people myself. I never qualified as a farmer. On page 8 I observe the relationship of income to invested capital in the farm which you speak about, investment needed for a farm calculated to return a reasonably comfortable living, so that $6,000.00 net per year, would be more like $60,000.00 to $100,000.00. I am rather suspicious some of this $60,000.00 to $100,000.00 is concerned with living. Does that figure include the house and it includes the equipment in the house so if one took those and assumes that would exist for somebody else who is not a farmer and who spent on those things we have got down what capital would be for the productive effort, am I right?

MR. KIRK: I think there is a factor there I would admit, but to the bulk of the farmers it is not very significant. It would be significant in some cases, yes.

THE CHAIRMAN: I would have thought that it would be. I would think they would keep the money and put it in government bonds and would be better off.

MR. KIRK: There are two points. In connection with the valuation of the house I think, in fact, the farm value tends to be quite low in this calculation. On the seoond point you raised, of course, the truth is one of the factors in this is the value of that land, and quite obviously if everybody tried to get their money out on the basis you suggest the value wouldn't be there very long. The demand for land by people who want to farm to some extent keeps the valuation there.

THE CHAIRMAN: I think to relate these two figures some kind of adjustment should be made. I suppose it is anybody's guess what that adjustment should be. Nobody would have any idea how much of the $60,000.00 to $100,000.00 might be applied to ordinary living costs rather than production.

MR. STEWART: You are talking here of capital valuation and not relating to living expenses.

THE CHAIRMAN: I am trying to relate the income to the capital required to produce the income as one does with most businesses and I would say that I think the capital required as I have it in paragraph 24 must extend beyond just producing income. I would assume that it does.

MR. KIRK: I think the amount would tend to be low, quite low. I would think on the basis of the way, of the estimate of valuation that the amount by which the total valuation is affected by the house is not large. I think it would be in the $10,000.00 category in the vast majority of cases.

MR. PARKER: If I may interject, I think

the analysis is correct. If the farmer doesn't like farming and doesn't prefer to live in a rural area and raise his family he would be very foolish to stay. If he is intelligent enough to farm today he can't afford to invest $100,000.00 because he could do far better to invest in government bonds if he trusts the government.

THE CHAIRMAN: I think the figures indicate that he has a relatively good way of life, not social benefits, not economic benefits.

MR. PARKER: That is right. I think he tends to ignore return on capital. In Alberta we have the Cost Accounting Management Service provided for farmers. There is a laboratory set up and there are about 80 farmers. They are paying to do it. They analyze those accounts. I know the ones who are staying on the farm, you couldn't get them off.

THE CHAIRMAN: Mr. Kirk?

MR. KIRK: At the same time the desire to live on farms - it isn't quite as simple as this, the investment and the occupation are tied together on the farm. They are not divisible. There is a real factor in terms of experience and training that affects this situation. If he starts a farm, particularly if he has reached maturity, middle age in his occupation it is not so easy to say I will take my money and invest it. Then what does he do? You need quite a large investment to live if you don't have a job.

COMMISSIONER WALLS: Isn't it the fact the average age of all farmers in Canada would be over fifty

which makes it rather hard to make any adjustment.

THE CHAIRMAN: I wonder if that is a fair statement. My father became a farmer at the age of fifty, a professional farmer, not a hobby farmer. He had to earn his living at it.

MR. BENTLEY: Maybe it is easier to make that adjustment that way than the other.

THE CHAIRMAN: I think perhaps that may be true. I don't know what that proves, if anything.

COMMISSIONER [illegible]: There [illegible] for you to make reference to hobby farmers.

MR. STEWART: Along with his investment it has provided him with employment and recreation and a lot of other things that he would have to pay for in addition if it was just investment.

THE CHAIRMAN: That is quite true. It provides benefit beyond the economic and visible benefits, there is no doubt about that.

MR. PARKER: That is right.

THE CHAIRMAN: I am interested to see for the most part you concede that the tax system is not bad. You recommend recognition of the [illegible] social principles as well as economic and technical issues -- are you conscious of any social matters that affect the farmers which are not properly taken care of in the present Income Tax Act? I can't remember you drawing attention to any in particular?

MR. STEWART: I am sorry?

THE CHAIRMAN: I am looking at your paragraph

No. 31 where you draw attention to the fact the Commission must give explicit recognition to the profoundity and difficulty of the social, as well as the economic and technical issues. I am asking you if you are directing us to any social issues in your area which are not reasonably provided for in the present method of taxation. I think you have perhaps mentioned it with regard to sales tax. I can't think of any others in your submission.

MR. KIRK: Well, first of all our principal point is that there must be given explicit recognition

THE CHAIRMAN: Yes.

MR. KIRK: This does not necessarily involve the fact that there are inadequately met, but I think that there are some fields in which our organization does feel at the moment that these are inadequately met, and I think that for example it is within the field of education that there is a consensus among our people that there are too many areas in Canada, many of the rural areas that are disadvantageous educationally. Apart from this further question of the tax burden it is a question of property tax, the provision of the service. I think that it is the consensus in our Federation that it is demonstrable that the wide range of tax expenditures on educational accomplishment shows inadequacy and that rural areas are if anything sharply hit with respect to this.

THE CHAIRMAN: That surprises me. I rather thought Canada was quite outstanding in providing schools throughout its whole land. There are some pretty

obvious deficiencies, are there?

MR. KIRK: There are very wide differences. I am sorry, I don't have the figures. There are wide differences in the per capita expenditures, per pupil expenditures for education from province to province.

THE CHAIRMAN: We have seen these.

MR. KIRK: There are wide differences in the results, not perfect correlation between dropout and these levels of expenditures. Again I don't have the detailed figures before me but in regard rural areas and the educational demands of students in the past, we think there is a great deal of room for improvement in terms of the number of years of schooling, just that. I think that we [illegible] all have increasing recognition in Canadian agriculture that the whole field of what might be broadly called vocational training, vocational in quite a broad sense, is one that is going to need increasing expenditure.

COMMISSIONER GRANT: You wouldn't subscribe to the view, Mr. Kirk, that the knowledge which a child is given the opportunity of assimilating is in direct ratio with the amount that is spent by the municipality in educating that child, would you?

MR. KIRK: I think you couldn't maintain a perfect correlation of this, perfect correspondence. I think the data shows there is no perfect correspondence in interprovincial finances.

COMMISSIONER GRANT: In other words one province might pay $450.00 per pupil and another pay $275.00 per pupil as cost of education but what that

pupil gets is not defined by the amount spent?

MR. KIRK: Yes, I think it would probably be going too far to put any limit on, to say it is merely a matter of money. On the other hand you can't get away from the fact either that any business that depends on the provision of facilities in the excellence of teachers, and in the world where there isn't such an enormous over-supply -- there is an under-supply of the best quality of personnel that money does help. I don't think there is any doubt about it.

THE CHAIRMAN: Is this what you mean by paragraph 31, the Commission have regard to the profoundity and difficulty in the social as well as the economic and technical issues -- I would rather have thought you were speaking of the impact of taxation and social effects of the impact rather than the effects which come about from government expenditure, am I right?

MR. KIRK: Well both.

THE CHAIRMAN: Both.

MR. KIRK: I think I should re-emphasize our asking for government support has been make recommendations and judgments with respect to what expenditures should be.

THE CHAIRMAN: Right.

MR. KIRK: Our point was one can't have a tax policy without recognition of the elements of social equity and necessities of expenditures that go to that decision. That is our main point. All these public expenditures, you know, it is increasingly

clear that rational understanding of the relationships between expenditures and tax and all the reasons of certain taxes that might or might not be imposed is essential to develop a good tax element in the country.

THE CHAIRMAN: I think perhaps I have come to the point where I will take issue with you in the matter of income and sales taxes. I see in paragraph 35 you say:

> "It should be kept in mind that the income tax is adaptable to any desired degree of progression in rates. Present rates of progression need not be taken as given. It is a counsel of despair and bad public policy to say that resort must be had to sales taxes in order to sbscure the real incidence of the tax increase from th public".

I don't know if that is why one would have to resort to sales tax because one could well resort to sales taxes and make them perfectly obvious where the consumer could see he is paying them.

We will, of course, have to weigh the extent to which income should be taxed and the extent to which spending should be taxed and I have an idea that in view of our former discussion the impact of income tax on farmers may be different than it is on other people; that if the farmer by his activities receives benefits other than income and the cost of these benefits is in

fact a deduction in ascertaining income on which he is taxed, his tax base tends to be lower than the rest of us whose income is determined and include monies which are not deductible for tax purposes; they are expenditures for recreation, health purposes, holidays and golf and so on and so forth in which the farmer is not interested. He has got them all there and then.

I would have thought that the farmer therefore measures his income for tax purposes at a level at which the rest of us do not measure them.

That being so, I can understand that the farmer might stress income tax may be against a sales tax or am I being unfair?

MR. KIRK: Yes, I think that perhaps. It seems to me that it is a very dangerous proposition to make assumptions of what is an intangible income factor to the farmer that presumably other people just plain do not have because I think, in fact, other people do have intangible utilities, if you like, attached to their work -- all kinds of them.

People select the work that they like. They do it all the time, as opposed to something they like less.

I think in the urban context you have a greater opportunity to make these choices. You have a greater range of choices and I think that also -- while I think it is undoubtedly true that the farmer likes farming I think that also it is not fair to attribute a value to this.

First of all, they not only like their farm

they are in a position where this is what they know.

This is, I think, not quite the same thing as attributing something that someone wants to do for many grew up perhaps in that environment and with that life; but to say that therefore he is actually making more income than the urban people, and measuring it on a money basis, strikes me as an exceedingly doubtful proposition because you are right into the whole field of intangible benefits.

I suppose, you might argue that a mathematician who loves figures, loves mathematics, should pay a very high rate of taxes. He is so thoroughly happy in his work.

THE CHAIRMAN: Did you ever hear of a hobby mathematician or a hobby lawyer or a hobby chartered accountant? I have heard of hobby farmers. There are people who are attracted to that type of recreation.

Certainly my friends who get into it pay an awful lot of money for the privilege of farming.

MR. STEWART: If a farmer spends his Saturdays and Sundays milking cows or cropping his land and doing work around the farm instead of going out and playing gofl or having a cottage one hundred miles away, then anything he earns during that period accrues as income. That is the position of a lot of farmers today. It is the long hours they put in. You cannot shut your cows off at 5:00 o'clock on a Friday evening. They have to continue working.

Anything they make over that period is accrued as income while the other fellow is spending his

income and enjoying himself.

MR. MUSGRAVE: May I point out, Mr. Chairman, my neighbours in the towns and villages hunt over my farm.

THE CHAIRMAN: They what?

MR. MUSGRAVE: They hunt over my farm, but I pay the taxes, when you are speaking of intangible benefits.

THE CHAIRMAN: You would prefer to do what you are doing than do what they are doing, I take it? You would prefer to milk your cows than to carry a gun over your farm.

MR. MUSGRAVE: Well, it is not a case of preference. It is a case of what has to happen.

MR. STEWART: I think we have to keep a clear distinction between what you mean by a jobby farmer. We are talking about people who are making a living on their farms and the other is a sort of extraneous consideration.

THE CHAIRMAN: The only reason I put that in was as an argument to say that the professional farmer gets an advantage out of the farm that I think is denied to most other members of the community. That is evidenced by the fact that people go in for farming as a matter of recreation whereas they do not go for the sort of work that I do as a matter of recreation.

This is merely an argument to support the statement which I made that you are getting other advantages out of farming than income. I am not sure that you should not pay taxes on the other advantages.

That is what I am coming to. I think this is clearly arguable. I think perhaps you have had the best of the argument so far. I am not sure.

COMMISSIONER GRANT: On the other hand there are lots of professional men who engage in such activities as painting and do so as an outlet for their recreation.

MR. STEWART: That is right.

MR. KIRK: I mean, if you are going to make tax adjustments for this kind of thing, it seems to me, I don't know where you would end up.

It is true some people like to own land and take pleasure in doing so apart from their regular occupation and may be doing some of the work themselves but to use this as evidence that there is therefore some intrinsic value in farming and that farmers believe there is an intrinsic value in it in the sense that the farmer likes it -- you have a great many people in the cities who very much like being in the cities -- I just think it is a very doubtful proposition.

THE CHAIRMAN: Mind you, you have directed our attention to the social as well as the economic aspects here.

MR. STEWART: I think there has been an attempt to sort of take this into consideration and recognize the non-economic incentives of agriculture by eliminating the losses which can be charged against other income. This attempt, I think, to sort of eliminate the possibility of this sort of thing is quite effective in most cases.

THE CHAIRMAN: Yes, I think so.

MR. KIRK: The farmer is also paying a lower income to start with. If you add that to the tax structure you are doubling the disadvantages, are you not? There is also disadvantages before you get into the tax question at all.

THE CHAIRMAN: I am just doubting in fact the disadvantage to the extent that it is generally presented. I do recognize there is in fact disadvantages. At least, I think I do. I don't think it is quite measured by statistics. I think the farmer has got advantages which cannot be chalked up on the cash register.

MR. STEWART: One of the things we found comes up in our meetings is the function of the farm wife in this whole field. In many cases the farmer and his wife performs this operation and in fact the income all acrues in the husband's name.

I know that this applies in small businesses and in many other areas. This is a complaint of these operations which are basically family operations, that there is not any particular recognition given to the function of the farm wife in the operation.

THE CHAIRMAN: You mention that with estate taxes here. I thought when we come to that, we will deal with it. It is a very important matter. This is not the first time it has been brought to our attention under the heading of estates.

MR. STEWART: We know it applies in other small businesses as well.

THE CHAIRMAN: It is an important matter indeed.

The other question with regard to income tax and farmers is, I suppose, the difficulty of measuring farm income, although I don't think it is as difficult now as it was twenty years ago because farmers belong to marketing boards. They sell their goods through cooperatives and so on where they get returns. It is pretty easy to see how much money they have received; although I would have thought many of them must have some difficulty in arriving at net income for tax purposes because you cannot do that without keeping some kind of a set of books.

Most people in economic activities have to keep some kind of books. You have an awful lot of members here who are very small and their bookkeeping must interest them very little indeed.

Do you hear many complaints about the difficulty of keeping books, making up tax returns and so on?

MR. KIRK: This has been a continuing problem, of course, and a great deal of effort has been devoted to meeting this problem, I think, with a good deal of success. "Farmers and fishermen Tax Guide is one example with which Mr. Stewart has had a good deal to do for years with the development of that publication. When you say "Do we get complaints" - from whom?

THE CHAIRMAN: From taxpayers. Do they say it is impossible to keep their books straight and make out tax returns and arrive at income for tax purposes.

MR. KIRK: I cannot say for the rest of my delegation but I would say not a great deal.

MR. STEWART: No, I think that is right. Fifteen years ago every time we would have a convention we would have a whole list of resolutions on income tax. This has practically disappeared. We have had very excellent liason both with the Department and through our farmers.

Some farm organizations have employed consultants to assist farmers in understanding these things.

In Ontario we have had public meetings every year for the last fifteen years where top men from the income tax along with top men from the Federation meet the public and try to establish some uniform interpretation of these different regulations and understanding of the procedures and processes which go into income tax returns.

Farm accounting courses have been conducted by the extension department and as a result of all this, the resolutions are practically non-existent on income tax when we go to a convention any more.

THE CHAIRMAN: At one time I think it was mooted that income tax should no longer apply to farmers. There should be some other tax substituted. I never knew what the other tax was simply because of the difficulty of arriving at income.

MR. STEWART: Well, I haven't heard of that for quite a while.

THE CHAIRMAN: Not for a long time.

MR. STEWART: No. I think they were talking of a tax or a sort of tax on farmers lands, which would be a most inadequate approach to it.

COMMISSIONER GRANT: Would farmers report on a cash basis?

MR. STEWART: The majority of them do. I think this simplifies the accounting procedures and while it might vary a little from year to year through an accrual basis, I think the reason the income tax people accept it is that feel eventually they will catch up with any inequities that have developed.

Cash accounting from year to year does not necessarily reflect farm business but over a period of time it will even up.

COMMISSIONER GRANT: Most farmers adopt straight line depreciation, do they not?

MR. STEWART: Most of them do, yes.

COMMISSIONER GRANT: Do you find that the accounting services which have been provided in various parts of the country through the provincial federation has been used to an increasing extent? You know the services to which I refer.

MR. STEWART: Yes, I do. Quebec have a lot of that right now.

MR. KIRK: That is right. I am not familiar in detail with the way in which these activities have gone on. You know that the Union Catholique des

Cultivateurs, which is our major member organization in Quebec, the membership organization employs -- I forget the figure -- I think perhaps it is something like 20 people engaged in income tax consultation services, which, I think, reflects the full acceptance of this as a part of the business of farming.

COMMISSIONER GRANT: Yes. Some provinces are not restricted on their limits for income tax consultation but include farm improvements.

MR. KIRK: Yes.

MR. STEWART: And estate planning and this sort of thing, in Ontario we have never gone into the actual proportion of farm improvements, as far as the Federation is concerned, but have maintained a liason service whereby any questions or requests for assistance are dealt with more or less informally.

We act as liaison between the farmer and the income tax department. We have not attempted to work directly with regional or district tax offices. We take the stand that if a farmer cannot get along with the people in the district office there must be something wrong in the relationship and we try to work this out with head office and reach an adjustment. I know the Farmer's Union had a tax consultant.

MR. PARKER: They have a staff. They have retired bankers that have nothing else to do. They are employed for a short time to assist.

COMMISSIONER GRANT: That may be good and that may be bad.

MR. PARKER: I will leave it to you to

interpret.

MR. STEWART: We have a number of accounting services in Ontario with different degrees of efficiency and effectiveness. There are accounting services available to farmers but they are not sponsored by the Federation.

THE CHAIRMAN: Mr. Kirk, on page 13, paragraph (b) "a rising level of taxes (either absolutely or proportionately to national income" or proposals for such a rise, can and should be related to specific needs that have identifiable purposes. The purpose of such expenditures (whether welfare and income transferring, or economical and productive on a proper social and economic analysis) can, if understood and accepted by the public, have a real bearing upon the kind of taxes (proportional or progressive) that are in turn acceptable".

You have in mind a kind of tax which should be segregated through national funds -- welfare, as you say, on the one hand -- and revenues raised by taxes, I take it, on everything in a general way.

Do you think it should be on a proportional rather than on a progressive basis, because I think that is what you are putting to us. There are some which I would think are the pooling of services for all of us, and as such represent only to a minor extent the transference of income, security of the aged is, perhaps, one. We all get something out of that. There is a transfer element in it. As such I suppose when there is a transfer element in it it is fair to be on a progressive basis and when it isn't it isn't fair.

MR. KIRK: Again our principal point was that the matter should be understood, the kind ofdecisions that are being made, so that a judgment could be made by the public as to the whole of the planning process. When it comes to an amount the Federation feels it should be a rate of progression. I think we can say on the whole our Federation has favoured the concept that a rate of progression is equitable. Many of the tax rates -- that there should be an income transferance effect for certain major areas and social expenditures. Now, if you say how much,in a particular case it would be much more difficult. We haven't defined this in mathematical terms, nor do I think we as an organization really have a mandate in the terms of the consensus of our organization to go much further than the general statement of the general nature in the direction of our thinking. This is a question on which the most progressive authority is a national consensus. Our point here essentially in which farms must participate -- our essential point is that

again the application, the difference made between the types of expenditures -- in general an improved level-- really our point again is improved level of public understanding and appreciation of the decisions that are being made and the reasons for them is essential to arriving at this final consensus on this question of social policy which I said can't be simply defined once and for all at any particular time. I think it reflects the nature of society and the state of development and certainly I don't feel in any position on behalf of the Federation to try and attempt an exact, idealogical definition of where we stand on the whole question.

THE CHAIRMAN: Your paragraph prompted me to try and seek general principles. I think you successfully avoided stating any.

MR. KIRK: I think I began by stating in a general way the degree is necessarily part of a system. I think that is inherrent.

THE CHAIRMAN: It is a general principle. I concede that.

MR. KIRK: But the degree is another question.

THE CHAIRMAN: To the extent that transfer payments come into taxation I think you are saying they should be made by progressive taxation, are you, or am I putting words into your mouth?

MR. KIRK: Transfer payments?

THE CHAIRMAN: To persons.

MR. KIRK: Yes, I think that has been our view.

THE CHAIRMAN: Yes, I think so.

COMMISSIONER MILNE: Just out of the Chairman's last question, in paragraph 42 you suggest that the Commission should pinpoint the nature and significance of these public policy questions and you suggest that public information and education could be designed to assist. You do feel that there is something that could be done?

MR. KIRK: Yes.

COMMISSIONER MILNE: In the way of public education, I mean.

MR. KIRK: Yes. Our feeling is we tend to work a little at cross purposes in the development of public policy in this field. We don't relate our expenditure policy to our tax policy. We tend rather to avoid relating them and getting sort of a rational discussion of the decisions we make. We rather avoid that.

COMMISSIONER MILNE: This matter of public information is such an overwhelming problem, the manner in which it might be accomplished.

THE CHAIRMAN: When you raised it I must say I thought that your Federation could do great things with regard to the assimilating of information, and I have no doubt that you are. You speak about the need for taxpayers to understand income tax better. I am not too sure this is a job to be done on the public purse or whether it shouldn't be done cooperatively with government and organizations like your own. I think cooperatively it might be more successful.

MR. KIRK: Yes, I think that is true. I think really our thinking is, of course, the question of how you do this in detail -- over the years, you know, there are many organizations who have responsibilities here as well as government and official bodies. Our thinking was, of course, that the Commission could make a very great contribution by laying a means of identification of issues and problems of this nature and greatly assist organizations like ours to go on with the job and to ease the job by having such analysis, such discussion as is now before the Commission.

MR. STEWART: We have an organization involved with the tax division in Ontario in arranging public meetings and carrying them out. The Federation calls the meetings and arranges for the halls and all this sort of thing and this I think has been very useful, a cooperative effort with the Province of Ontario for the past fifteen years which has resulted in a uniform interpretation for administrative purposes of the Act, understanding it.

THE CHAIRMAN: Yes. I am going to page 14 unless anyone has anything further.

COMMISSIONER GRANT: Before we get too far away, there is an observation in paragraph 40 which I would like to refer to. That the income tax is well adapted to bring about a quick and effective adjustment in tax. I am under the impression that the economists and fiscal experts don't agree with you, that they say income tax is rather a slow method of bringing about any adjustment, and if fiscal policy is to be

used to augment or adjust or influence the economic situation that it is most effectively used in such things as sales tax rather than income tax. Sales tax can be put on and be effective over night by Order-in-Council whereas income tax requires calling Parliament or passing an amendment to the Income Tax Act. That all takes time. Also any amendment, I believe, is effective only the following fiscal year.

MR. KIRK: Well, perhaps -- I must confess that I didn't think of the problems in the terms of legislation. This statement flowed from the point of view of thinking in terms of what you can do with it, and assuming, I guess, you had authority. Certainly income tax could make a sharp, identifiable and known impact, known to the taxpayer very quickly upon his net disposal income position. If, of course, the question of authority and legislative procedures is, if this is the situation and it is unchangeable then, of course, I quite agree it does affect this position. Whether it is changeable or not I don't know.

THE CHAIRMAN: Would you like to comment on that, Mr. Blair?

MR. BLAIR: I have been thinking of what the problems are. There is no reason that there has to be this immense time lag, no legal reason. It all gets bound up with practicalities of legislative programs, but there has been this tendency to make tax changes more or less effective for the following fiscal year.

THE CHAIRMAN: Sometimes in the middle of the

year.

MR. BLAIR: I am not so sure what was done in some of the dramatic tax changes made during the war years. I think they were made immediately and no time was taken to have legislation passed -- they simply started the system and put the Bill through quickly.

COMMISSIONER GRANT: At the present time, Mr. Blair, you would agree that once a rate is fixed it is fixed by Statute and would have to be amended by Statute?

MR. BLAIR: That is right, but that is not to say that the Statute couldn't be changed quickly if the public policy decided it was essential in the public interest to make this tax change. This could be made practically over night. Changes generally speaking date from the date of the Budget.

COMMISSIONER GRANT: Some do and some don't. I don't think tax changes in personal or corporate taxes ever date from the date of t he Budget.

THE CHAIRMAN: Sales and customs tax on exports. I am curious as to why you feel so strongly that sales tax should not be levied on foods. I can understand that up to a certain marginal extent, for social reasons it is not a good idea to tax food. There is a high degree to which it is considered to be essential. Beyond that essentiability I would think that it should be a taxable commodity as any other commodity, and certainly the point at which many of us are consuming it it would seem not only to justify sales tax but excise tax also. I think I would be better

off if I was taxed on food. There is a point at which I agree that one can see justification for exemption. I suppose it is put on the basis, all food being exempt, because one has never found a means of exempting so many calories and taxing beyond that. If that is the only reason we may be able to find an answer to that.

MR. KIRK: Our first point is we think it is a fact. Agreement with this is reflected in Canadian law. There is a lot to be said for not putting a tax on this basic commodity of life. The need for food is separate from your income position. It seems to me the validity of this position is stressed when you consider also the fact food is something everybody eats, that is to say there is no discriminating effect between groups depending on consumption habits to the extent you might get that with some other things. What you are doing, it seems to me, is eliminate a sector of the field of consumption expenditures for the purposes we mentioned and that you are not creating, in doing that, it seems to me any great difficulties. Of course, it does mean for a given level of revenue you have to levy higher levels of taxation in other ways. What is wrong with this. If you were talking, for example, of liquor tax there are other considerations involved. You have a special commodity, no uniform consumption. It seems to me you create no difficulty to anybody in this sector, everybody eats food. Your rate is adjusted in other areas to meet your revenue needs.

THE CHAIRMAN: Do you know whether anybody has ever studied and ascertained to what extent the value of food consumption is progressive. Did the Royal Commission on Food Prices.....

COMMISSIONER WALLS: The Royal Commission on Price Spreads.

THE CHAIRMAN: The Royal Commission on Price Spreads of Food Products calculate as to what the value of consumption was by income groups.

MR. KIRK: I think not.

THE CHAIRMAN: I don't think I have ever seen one but I might well have overlooked it. You haven't seen that?

MR. KIRK: I don't recall seeing it.

THE CHAIRMAN: Because I suspect that consumption is fairly highly progressive. I don't know. You wouldn't have anything on the subject?

COMMISSIONER WALLS: I think [illegible] brought [illegible] above the $10,000.00 income there is no variation in the expenditures on food; in other words higher salaries above that level don't create any increase in the value of food purchased.

THE CHAIRMAN: There would be variation up to $10,000.00. That is pretty obvious. You haven't removed the thought from my mind that over and above a fair level of their consumption there is justification for sales tax as on anything else. Within the lower limits I think it is not very difficult to accept what you have to say but above that I find it very difficult to accept. There have been suggestions made, not only

in Canada but in other places that rather than accept the whole range of a commodity in all its purposes that an allowance be made for the amount of sales tax which was paid, assumed to have been paid, at least, in respect of basic consumption and that amount was established and was applied as a credit on income tax or refunded or something done with regard to it in order to get the moneys back to the taxpayer. You have probably heard of such suggestions that came up in the States and other places. Have you any views as to whether or not such is a reasonable approach to sales taxation on food?

MR. KIRK: It sounds like it might present some very real administrative difficulties.

Of course, it is a little hard to argue -- I don't know perhaps we would attempt to do so -- that on higher income levels you have a need, you know, to have a tax exemption on food from this particular point of view, but our position is that and our argument is that the grounds for exemption on food is valid as far as it goes. It is reinforced by other considerations. One is the known ability to identify the export sector of the agricultural production, part of the product that is exported, in our sales tax legislation that works where you can identify ---. You get a calculated adjustment of that tax.

That is another factor and a third factor is that particularly in view of the fact we do not really see the necessity for going for food. We do not think that is a good thing from the point of view of the lower income groups and no harm overall. We are also concerned about the fact agriculture is in this general position of a slow adjustment of attrition that the short run effect -- at least by "short-run" we mean a fair number of years -- I don't know how many. It may be ten or fifteen, the short run effect of the exemption of the tax the incidence will be on the farmer to a considerable extent. We do not know. This goes to reinforcing these other considerations.

This tax is a combination of what we think are a number of factors all with considerable validity that add up.

COMMISSIONER WALLS: If the tax was moved forward to the retail level, you would not think that

the farmer would have to carry the load. I can see your argument for dealing with it as a manufacturers tax or producers tax at the present time but if the tax was moved forward to the retail level it would not mean that the farmer would be forced to absorb the tax, any more than he has today with the Provincial Sales Tax.

MR. KIRK: That is an interesting point. I am not sure that would be altogether true. If you in fact raise the cost of buying food even by the imposition of a percentage tax at the retail level by a sales tax you nevertheless will affect consumer decisions, I would think, because you are changing the price relationship to the product on the market in terms of what the consumer pays for them; and having changed that relationship, changed the purchasing decisions of the consumer, it is through that process of change in the short run or in the long short run tends very strongly to be reflected in lower prices of the farm product.

So, I am not quite convinced -- I agree with the fact there might be a difference in the degree of the incidence. I am not at all convinced, Mr. Walls, that this would be true - there would be no such effect.

COMMISSIONER WALLS: Well then, if you followed up the suggestion that was made by the Chairman which is being discussed in some other countries, you correct the regression by some other form of rebate or payment. If the tax is moved forward and you have some type of payment that would correct any regression

that there might be?

MR. KIRK: It might to some extent. You are complicating normal consumer decisions by having a rebate at a later date in a sort of bulk form. It might be July or the year after. You are getting into a very complex question of effects.

THE CHAIRMAN: I say it would simplify consumer decision. It is the most neutral form in which the decision may be made, neutral as to taxes.

MR. KIRK: Yes, but our point in connection with this incidence question is that it is the change that creates this incidence on the farmer for a period.

MR. STEWART: The consumer may not porject his thinking to whether he is getting a rebate. He is thinking only of what it costs him at that particular moment.

MR. KIRK: It is the event of the change in this particular action. Our point is that it is the event of the change, that that creates a short run incidence on the farmer. We are not claiming on the question of incidence that if forty years ago there had been this neutrality of which you speak, that the incidence would be any factor at the end of that time.

THE CHAIRMAN: I cannot really conceive of how this is going to affect the farmer unless the consumers have exercised their choice so as to use less farm products and take something else because of the tax. What subsitute is there for food? I don't see how that choice could be exercised so as to cause ill effect to the farmers but there may be some substitutes

I have overlooked.

MR. KIRK: Their choice between foods. There are more expensive foods in terms of caloric content. Also nutrition is more desirable. You can certainly get a shift on expenditures in that nutrition is more desirable but more expensive because of the greater amount of farm inputs into them today.

You can certainly get a shift in the balance of expenditure between foods.

THE CHAIRMAN: You are not arguing that income would move away from the farmers but income will go to the farmers differently than it now does. You are not saying whether this is good or bad.

MR. KIRK: We are arguing about the total of expenditures that goes to the farm product which would be reduced and this really will very strong tend to be -- not that the level of consumption will stay down but that the level of farm prices will go down and the level of consumption will return. That is our point.

THE CHAIRMAN: I think I understand it. Let me set it out as clearly as I can: That should there be discernable taxes imposed on foods, that a lesser proportion of the family budgets would then flow to the foods because some of them would not be purchased because of the taxation.

MR. KIRK: That would be the initial effect.

THE CHAIRMAN: So there would be less money going actually to the purchase of foods. That is what you are saying.

MR. KIRK: Well, yes, but there is an initial reduction in the volume of purchases or at least the volume of purchases in agriculture. The initial reaction is a reduction in returns to the farmer through a reduction in a demand for food at that price; but the effect will be not so much to leave the level of consumption lower at that price but the affect will be for the price to be forced down and the level of consumption to return at a low price level, because of the great inelasticity of supply in the short run in agricultural production.

THE CHAIRMAN: If the same money is spent at a lower price level, I suggest to you the farmers are not very seriously affected; the food processors and distributors are; that the difference in the price level is more packaging than it is food. Am I not right?

MR. KIRK: The amount of the price is more attributable to the cost of processing than food. Proportionately it is 55 per cent processing to 45 per cent food or something like that. The lower the price will go, our experience is that the processors do not in fact reduce their margins in the face of lower prices for food.

THE CHAIRMAN: No, I am not suggesting he does. I am suggesting that the consumer choice would be exercised so as to buy less packaging rather than less food.

MR. KIRK: Yes, in part, of course. You are suggesting that the shift would be between less and more packaged foods.

THE CHAIRMAN: Yes.

MR. PARKER: I think the chain stores on the North American continent today tend to influence almost to dictate to the housewife what she buys by national advertising and to impose a tax, the tendency on the part of the chain store purchasers will not be to a lower price to compensate for the increase in taxes. That would take place initially. We are convinced now that chain stores determine to a very significant extent the prices they pay for the raw product from the farm. I am speaking particularly of beef and meats. These chain stores -- their terrific purchasing power concentrates an unfortunate influence, I think, as far as the farmers are concerned. It may be to the advantage of the consumer.

THE CHAIRMAN: I can understand where price differences may be passed back to the farmer when the farmers were not organized; but farmers have since become or are recently becoming very well organized with their marketing boards and cooperatives and so on. They must be able to bargain on pretty equal terms with the purchasers, are they not.

MR. PARKER: I would say just in some products.

MR. MUSGRAVE: May I give you a classic example about packaging.

THE CHAIRMAN: Yes.

MR. MUSGRAVE: A few years ago we used to buy salt for about half a cent a pound. We wanted it in more convenient packages and in smaller amounts. Now,

if you would take the price of salt as you get it in the little container in an aircraft it is $80.00 a pound.

THE CHAIRMAN: That is an interesting example. I think we may break at this point for about ten minutes.

---Recess at 11:08 a.m.

THE CHAIRMAN: We shall proceed if you gentlemen are ready. We were talking about sales tax and I take it from your statement on that subject that you are not dissatisfied with the level at which the sales tax is now levied. You are not recommending any change in the level, anyhow. You feel that the Department has been very fair and cooperative, and generally you find very little the matter with the sales tax law; is that correct?

MR. KIRK: That is correct up to a point. We find it fair and cooperative. Our experience in this kind of thing is if you approach this thing in a good way that the treatment you get is fair. As to our recommendations with respect to the application of the sales tax I think it is not right to say that we think it is fine as it is. Our recommendations are for a considerable expansion of the exemption, not only for farmers but for others.

THE CHAIRMAN: Paragraph 53 and 55 dealing with machines and apparatus.

MR. KIRK: That is right, and we don't favour the changes that have been made in the Act with respect to machinery and apparatus and building materials and we would like to see, if possible a more thorough application of the principle that sales tax should not be levied on goods that enter into cost of production or whatever it is. You have a product in connection with things like automobiles, gasoline, you know they are multiple use products. Some enter into the cost of goods. In principle we feel it should

not be levied on goods entering into the cost of other goods.

THE CHAIRMAN: Does it affect your members to any large extent or are you just concerned with the general goods?

MR. KIRK: It would certainly affect our members on quite a number of things. We, of course, do recognize, for example, the income tax exemption section lists all these various items -- that there are not many items that would otherwise have been levied tax under this machinery and apparatus removal. They will now be covered under the specific items. In the case of building materials, in the case of quite a number of specific things there will be new sales tax as a result of the change of the law and we think this is wrong in principle. The full application of what we are recommending would, I agree, possibly have a greater implication for some other sectors of industry than our own.

THE CHAIRMAN: I am trying to fully understand how it affects you. I know machines and equipment would have some sales tax which wasn't previously there, and even though your members buy them sales tax exempt there would be no exemption so far as sales tax applies to the machinery used to make that equipment. Again the same thing would apply to building materials in the production of the farm machinery. Then, I suppose the building materials which are purchased for the farm are now subject to tax, are they, whereas they weren't before.

MR. KIRK: Yes.

THE CHAIRMAN: Putting up a new barn, you now pay sales tax?

MR. KIRK: That is right. There are some items that have always paid sales tax that we feel in principle -- we don't see the difference in principle between a farm fence and a farm motor. They are both very valuable costs of running a farm. You do pay tax on farm fences because the definition of materials entering ~~used~~ into production. The way that is interpreted farm fences are not included. It is more direct consumption of the material than that, and that is the way it has been interpreted over the years.

MR. MUSGRAVE: There is one other point, if I might make it. One of our Ontario members, a member of the Ontario Federation United Cooperatives is engaged in building homes for senior citizens, apartments for senior citizens. It is called Twin Pines. They are under the limited dividend section of the Housing Act which limits them to 5 per cent. It costs 5 per cent for the money so it is a non profitable endeavour to satisfy the social requirements of the cooperatives. The idea there is to get the rent as low as possible. Municipalities when you put up one of these apartments make tax arrangements and give you a certain level during the amortization period of 45 years or whatever it is. This tax on building materials has made it very difficult for United Cooperatives to continue in this building. There are some ten of these apartments now in operation and they rent for $45.00 a month for

single to perhaps $50.00, perhaps a little over that, for two persons, a couple. We think it is a pretty good thing. It has received approval from the Government people, assistance for the aged. It is a good thing. With this sales tax on building material it puts a serious crimp into it.

COMMISSIONER GRANT: The fact it is a fine thing is not in question. Undoubtedly it is a fine thing. To put up a building of that sort, when the costs are worked out and the return is calculated, is it not possible to pass on that increased cost.

MR. MUSGRAVE: That is right.

COMMISSIONER GRANT: By way of increased rent.

MR. MUSGRAVE: That is what would have to happen.

COMMISSIONER GRANT: The senior citizens now, if they are over the age of 70 are getting $75.00 a month. This was increased $10.00 a month since the last few months. If the revenue is needed and they can get more in return from the government which needs the revenue for that very purpose, is it not reasonable that they might share in that increase.

MR. MUSGRAVE: If it appears that this could happen, that these apartments could be filled at the higher rate then Twin Pines will go on.

COMMISSIONER GRANT: You haven't any evidence that building has been curtailed or expansion of this type of building has been curtailed as a result of the sales tax?

MR. MUSGRAVE: Yes, we have, sir. Twin Pines has cut down its plans for further construction until we see just what is going to happen.

COMMISSIONER GRANT: Do you relate it solely to the increase, the 4 per cent which is applicable now?

MR. MUSGRAVE: Pretty well, sir, because this thing was figured pretty close to the margin. There is not much to come and go on. The idea was to make it possible for as many people as possible, people who are in reasonably good health - this is not charity -- this is simply providing dignified and separate accommodation for people who wish to provide for themselves if they are in reasonable health and over sixty with a certain minimum income and they must not have more than a certain maximum or they can get accommodation somewhere else.

COMMISSIONER GRANT: C.M.H.C. supports?

MR. MUSGRAVE: Yes.

COMMISSIONER GRANT: They bear a very high percentage of the cost of construction.

MR. MUSGRAVE: Oh, yes. I think it is 90 per cent.

COMMISSIONER GRANT: This is a government agency that is putting up most of the money.

MR. MUSGRAVE: That is right, they put up the money, but they get paid back.

COMMISSIONER GRANT: They get paid, but the institution of putting up the accommodation, the cooperative institution or any organization, company, or your organization that is putting up the building know

that if they put up these apartments at a reasonable price and rent them at a reasonable price they are very sure of getting their money because the old age pension cheque is there as a first charge on it. The government is again paying rent for these people in a sense.

MR. MUSGRAVE: Yes.

COMMISSIONER GRANT: I just wondered that there would be such an objection to the increased sales tax. I am not arguing in favour of the sales tax. I am arguing the principle.

MR. MUSGRAVE: A number of these people are not 70 and are not getting any government old age pension.

COMMISSIONER GRANT: Are they retired?

MR. MUSGRAVE: Yes, they are sixty years and over.

COMMISSIONER GRANT: They have means of their own.

MR. MUSGRAVE: They have to have. These are not poor, it is not poor accommodation. It is good accommodation.

COMMISSIONER GRANT: I think it is a wonderful thing. It is most desirable. I am all for it. I was solely questioning you on the point as to whether or not this program of yours bogged down as a result of sales tax.

MR. MUSGRAVE: All I can say, I sat on the Board of Directors of Twin Pines -- I am not now on the Board. I sat on it for three or four years. When this building materials tax went on we got word from

management that we would have to slow down a bit and see what effect this would have before they would go any further. It would certainly mean an increase in the rent and they would have to check and see -- before C.M.H.C. will go ahead on one of these there has to be a survey to determine the demand. The rate of rent has an effect on demand.

THE CHAIRMAN: I think that is all on sales tax. Does anyone have anything?

COMMISSIONER GRANT: Nothing except an observation which was made on I think, page 15, paragraph 50. Perhaps this question is for you, Mr. Kirk. You argue against the imposition of sales tax on exported goods and then you say so far as the application of such a tax to the export of agricultural products is concerned that it is impossible to recover that tax. If a product is selling on the world market and if it does bear the sales tax, be it an agricultural product or anything else, and is competitive, then there is no reason why the producer or the manufacturer should have to bear that tax, is there? It is a matter of what price the product will bring on the world market.

MR. KIRK: Our point was this is a matter of administration. We are talking about, if you have sales tax on goods that go into the cost of wheat, for example as compared to automobiles -- a portion of the automobiles let us say are exported, it is possible for the firm to identify the proportion of their costs that goes into export and to get sales tax exemptions, as I understand it, on that. In the case of

wheat there is no such identification of the product that goes into the export that is sold, delivered by the national group as wheat has a multiciplicty of uses and the identify of the wheat is lost. It is identifiable only by wheat, in the form of origin, and it presents an extreme difficulty, possibility of returning the sales tax proportion to the farmer on the basis of the amount of this product that is exported.

Well, in this connection, mind you, our overall position is there should not be such a sales tax. This, in our view, is a strong reinforcing argument for agricultural exemption generally because we do feel that certainly the export argument is a very strong one too.

The export question, of course, would be much less critical if you did not have any sales tax on goods, on the cost of production of other goods in the first place. That is our initial position.

THE CHAIRMAN: I am moving now to taxes for education because I don't think I have any observation or questions on customs' tariff. It seems that does not concern us very much.

Now, you say "The necessary revenue should be recouped through increased Federal income taxes and their payment to the provinces on a formula basis -- no strings attached".

Why move to the Federal government? Historically, I think, education has been a local matter. You want to keep the administration local, I believe, from what you say here. Municipalies are creatures of

provincial governments. If there was to be a shift from the municipalities in respect to primary education, I would have thought the shift should be to the provinces or in the alternative, that other sources of revenue should be made available to the municipalities, such as a municipal income or sales tax or something of that kind.

Surely, one can't expect to move it over to the Federal government without the Federal government exercising some form of control as to how that money is to be spent.

Do you wish the Federal government to in any way control school expenditures at the municipal level?

MR. KIRK: Well, first, I think that this question represents what we were talking about earlier, of the general bias, if you will, to use a word, of our organization towards the equalization of the burden, the equity of burden and equity of receipt of services. Our policy was developed in the light of that.

With respect to use of federal income tax, it was at that time thought that there are inequities; that income tax is adaptable to greater equalization among all the citizens of Canada for the burden of this important cost, which is a national question, in terms of its importance for the future of the natio, sir.

Now, some of these requirements would not be met, for example, by additional tax revenue to the municipalities of other things. Some of the problems with respect to property tax might be adjusted but not

all the problems. I think we make the observation in here, of course, that this is costitutionally an area of provincial responsibility and even since this policy was adapted by our organization in Canada, as a whole, there has been increasingly intensive, as we all know, inquiry and thought and discussion of this whole question and so we are saying therefore that on the constitutional question, we are making the point from the point of view of the direction of our farmers' thinking on this question.

We have felt that it should be possible to make these expenditures, to make this money available on a formula basis that will not in fact impinge upon provincial autonomy but we are prepared to recognize this is an area in which people feel exceedingly strong for reasons outside of the tax question. We do want to recognize that.

THE CHAIRMAN: Thank you very much. Any further questions?

COMMISSIONER WALLS: Am I right in thinking that what you say is that some sort of tax sharing agreement by the provinces in areas where they are short on finances for that required standard of education; there should be some equalizing factor by the federal government that would draw from the wealthier provinces and give to areas that could not afford to have the same standard of education.

MR. KIRK: That is one of our purposes. The second purpose is use of the federal income tax to ensure uniformity of the burden in terms of who pays

to the individual payments.

MR. PARKER: The main problem here is that many of us feel that taxes on real property, particularly agricultural land for the purposes of education has become unbearably heavy. It is beyond the productive capacity of the unit in many instances.

Basically I think income taxes in fact should pay for education not land itself, which may not produce income. How the federal government and the provincial government sort this out politically, we are not concerned. It is a political question.

THE CHAIRMAN: Thank you.

Moving on to capital gain. I must say I find your argument very interesting here. It led to the question of whether an inequity did not arise in the area of farms because of the freedom of the retirement income -- the capital gain and the retirement income from sales of a farm -- from taxes. Most people who have saved up money in one form or another pay taxes on that saving.

Your argument is that farm people need these monies as a legitimate source of retirement income. I think that is perfectly acceptable -- and desire to have that left untaxed. I am sure they are very deserving people but why should they observe more than anybody else freedom from taxes on retirement income?

MR. BENTLEY: Well, Mr. Chairman, we recognize basically that the only retirement income farmers have is in the farm.

They are not normal like city people who may

may be able to invest in annuities out of their income each year and through a combination of pensions and annuities of one kind or another are able to provide for their retirement.

In the case of a farmer, all the money he is able to get together he usually puts into improving the land, buildings, livestock and machinery and so on. He has no cash in the bank to speak of or any annuities of any kind. Therefore when he sells out his farm what he has built up there is really his retirement or his annuity fund.

We think that this is so over a long period of time. When a person goes farming he is usually there for thirty or forty years which is a long period of time. There may be some increase in the value of land values in the meantime but also there is a great increase in what he is improving, the productive capacity of that farm.

This is rather difficult to measure but we say that basically we are opposed to a capital gains tax certainly with respect to farmers.

THE CHAIRMAN: Yes. Well, I can understand that. I think I know also that people in countries which do not have limits imposed on what we call hobby farmers, which means their losses are really restricted to $5,000.00 and these people working in the city who are not full time farmers usually take full advantage of this when the rate of taxes are high.

I am thinking of the United Kingdom and Australia where people in the cities generally own

farms and the purpose of that is to lose a lot of money, to develop the farm and improve the farm and then eventually sell the farm and getting their capital gain tax free. A very attractive proposition. I think we would do the same thing in this country, if it were not for the $5,000.00 limit. More people would get into farms and get a tax advantage.

I think the professional farmer gets some of that advantage but I think what you have said is that if society taxes that, there probably would not be enough left to take care of his retirement in a proper way. I do not see the justice really or the economic justice for that tax. It may serve some social justice if those people on the average would not be well enough looked after if they were taxed.

MR. PARKER: Mr. Chairman, we are only concerned with what we call the legitimate farmer, not the hobby farmer or one that is attempting to do something, as you suggest, to evade taxation.

What we are concerned with here is that the farmer doesn't keep a set of books that will indicate clearly all the monies he has put back into the farm, he has been subjected to personal income tax over the years in which it was accummulated.

If he is not able to show that then if the farm is sold or divided by death, on his net worth he is subject to terrific taxes.

This is what we are concerned about, generally speaking.

Certainly it is true in western Canada farms

change ownership every generation, generally from father to son, that sort of thing, or son-in-law, but to repeat again, in the main the average farmer does not keep a set of books over the last twenty or thirty years that would enable him to demonstrate that money he has plowed back in general improvements for machinery, livestock or buildings.

His money which has been recorded each and every year has been subject to income tax. Therefore when he sells out, if there was a proper set of books there would be no capital gain in the true sense of the word. That is our contention.

THE CHAIRMAN: I am having a little bit of trouble following you there, because only money that should be used or should be included in the cost basis which would be subject for cost receipts from the sale of the farm. You have other monies which were not deducted annually and went to pay his income tax. That should be capital expenditure not revenue expenses.

Are you suggesting part of these revenue expenditures, because he doesn't keep a record, he wouldn't know what to deduct.

MR. PARKER: This has traditionally been true. Going back to some of our discussion, because of the fact that the new farmers are becoming business men, there is a better set of books gradually evolving but we are concerned about the great many older ones.

If you had a capital gains tax in this country, then this farm, travelling from father to son, will present difficulties and some hardship in many

instances.

I think there has been instances where there has been no tax filed, which we don't agree with.

There has not been a net worth statement. This farm has to be sold in order to clear up succession duties and income tax and all the rest of it so that frankly we are opposed to a capital gains tax for those reasons.

There are fringes, of course, where we are getting into something where there is a farm turned over in a couple of years. There may be a significant capital gain to the individual but for the mass we think it is insignificant.

THE CHAIRMAN: Yes. I am not talking about speculative gains.

MR. PARKER: Nor were we either.

MR. KIRK: I think, Mr. Chairman, that it is part of our attitude that because this is related to the long term question of gains that because during this term income returns to the farmer had tended to be relatively low, as we explained in the beginning of our brief; in view of the fact that in order to maintain himself and to meet technological changes, he typically is not able to take advantage of income tax exemptions and annuity provisions.

Our point is that in view of all these things, not so much that they are precisely very comparable instances, except they all add up to the fact that the income burden in terms of tax equity -- to impose a tax on capital gains in view of this

experience over a long period of time which, on the whole, is not a favourable experience from the point of view of income or from the point of view of the accumulation in any other form of retirement funds, that the real result in terms of equity and treatment, there would be inequities in a capital gains tax on farm lands.

THE CHAIRMAN: I don't think the point you make with regard to the income tax deduction in respect to a man saving for retirement is valid. He is entitled to purchase an annuity, a self-employed retirement plan -- I have forgotten what it is called, up to a limit and that law, if I remember correctly, was brought into the Act so that people who were not employed might secure roughly the same benefits as employed people.

MR. KIRK: Yes. My point is not that it was not available in the legal sense. Our point was that the typical farmer is at a disadvantage incomewise and has been under continuous pressure to utilize what funds he did have to keep up with the technological position of farming that requires an increase in investment and he in fact is not able to take advantage of this even though it is available.

THE CHAIRMAN: Thank you. Any further questions?

Well, I note that you are against the capital gains tax, and I can quite see the point that you make. I am not sure how the points would stand up in distinguishing your industry from other industries if

there was a national capital gains tax imposed on all; whereas there is a good deal of social justice from what you say, whether that may be a strong enough argument to select farmers for exemption, I don't know. I would think that might be difficult.

MR. KIRK: Well, of course, as we said at the beginning, we do not describe any specific thing. When you say "capital gains tax", there are a lot of things you could do with that.

THE CHAIRMAN: That is quite right.

If there is nothing more on capital gains, we will move on to estate taxes on page 20.

I note that you feel that the basic exemptions are at too low a level. You make your case with regard to the economic size of a farm. You suggest really that farms should be exempted, I think, because you move the exemption up to $75,000.00 and $100,000.00 which would take the medium sized farm out of taxes.

COMMISSIONER WALLS: Have you given any consideration to the suggestion that has already been placed before the Commission, that instead of increasing the limit, that estate taxes not be due until the death of the last surviving spouse? In other words using your argument that the husband and wife build up the farm between them, that the estate taxes then ought not to be due until the death of the last surviving spouse. We have had that put before us. It may be an alternative to your suggestion.

THE CHAIRMAN: It suggests the estate be

considered to belong equally to both spouses.

COMMISSIONER WALLS: Yes.

THE CHAIRMAN: That perhaps is not quite correct because if the tax were only imposed on the death of the last surviving spouse, there would never be tax imposed when the estate moved down a generation, whereas yours may be in the same generation.

MR. KIRK: We did set up what we think perhaps as a valid general criteria that related to this question of raising the level of exemptions in paragraph 73.

We suggest that in connection with the estate taxes a general principle and criteria for this exemption level question and indeed, I suppose, for the rates of taxes, should be to avoid taking action which frustrates or diminishes the effectiveness of efforts made by man or woman in his or her lifetime to provide reasonably and soundly for the future of his or her family.

We suggest that really this practice is pretty sound, the way you should start on this question of taxing estates, that you should recommend a principle that is socially good and socially right to recognize the need to provide reasonably and soundly for the future of the family, and, of course, in the case of farming this is a particularly critical question, to provide soundly for the future and not disrupt the farm enterprises about which we are very concerned. This is a subject of vital application, we think, to this general principle.

THE CHAIRMAN: Do you think good farming is promoted by the farm staying in the same family, moving down one generation to another or is better farming promoted by very frequent sale?

MR. KIRK: I would guess it would vary from individual to individual.

THE CHAIRMAN: I am looking for a general rule. There isn't one?

MR. KIRK: I wouldn't think so.

THE CHAIRMAN: With regard to business one can see both, sometimes continuation of family ownership develops certain products and qualities good for the business and another time it simply runs out.

MR. KIRK: Yes this very thing occurs in farming, that a son of a father represents in a very real sense new management, a new deal in business enterprise that you spoke of combined with very great value in having the same farm he grew up on. He knows that farm, knows the land a nd knows the characteristics of it.

THE CHAIRMAN: That is right.

MR. STEWART: I think we all know instances where certainly a farm, where a good farm is carried on within the family it is a great advantage, but I think we can also point to situations where a poor farm probably doesn't improve. There is a great variety of situations.

THE CHAIRMAN: We can't provide tax laws to take that into consideration, I don't think.

COMMISSIONER BEAUVAIS: I have a question. When you suggest the first $100,000.00 is equally divided

between husband and wife, what happens if a man marries two or three times? He might marry and two years after lose his wife and then remarry, what is your suggestion in this connection?

MR. KIRK: We were thinking principally, I think in terms of the estate being formal property ownership in the hands of the farmer, the male member of the affair in which case this problem wouldn't be a problem, would it? It would only be the wife he had at the time of his death which would be involved in this situation.

COMMISSIONER BEAUVAIS: Not the second one.

COMMISSIONER WALLS: Maybe he deserves a reward.

THE CHAIRMAN: This is only a basis for computing tax at the time he dies. That is all we are doing.

COMMISSIONER BEAUVAIS: This $50,000.00 may be taxed two or three times.

THE CHAIRMAN: If it got chopped in two every time....

MR. PARKER: He would get to a point where he couldn't get any wives.

COMMISSIONER BEAUVAIS: [illegible] live for thirty years -- I understand very well once, but not twice or three times. It might very well happen, you know.

MR. KIRK: We didn't think that one through, sir, I must say.

THE CHAIRMAN: Any more on estate tax?

COMMISSIONER BEAUVAIS: I would like to ask a question here on the last paragraph of Section 80. "The tax too would then be assessed on a monthly basis out of the annuity payments". You are talking also of pensions. I suppose that a wife would retire, the capitalized value would be paid according to her age or life expectancy over the months or years. I suppose if a wife has a ten year expectancy then she would pay during ten years if she lived the ten years, but if she lived twelve years would she continue to pay for the extra two years?

MR. KIRK: Our thinking was first you take the capitalized value of the pension or the annuity and then you take the tax on that and then you pay that tax on the same terms you had the annuity, in terms of monthly payments and by the same rule so that if the life of the pensioner was prolonged then that much more tax would be paid. If it was short then that much less. That was our thought.

COMMISSIONER BEAUVAIS: When the tax is paid there is no more tax to be paid and if the wife lives longer than ten years, for instance....

MR. KIRK: No, it would be possible, for example, in some circumstances for the wife to die so soon that in fact she would recover less in the annuity than she owed in taxes in the first place. Our suggestion is this shouldn't happen, that at the option of the wife, of the annuitant, that the tax must be translated into these same terms so that in the event of an early death the tax would be similarily low and

in the event of a long extension of life the tax would be correspondingly high. This could be done, for example, requiring perhaps the payments could be spread over and not go into cash assets or something, a house or property of the annuitant -- you wouldn't have to use this up in order to pay tax. It seems to us that if the taxpayer wished to take this option that it would be pretty successful and it wouldn't, over all, in the aggregate affect the government revenue.

COMMISSIONER BEAUVAIS: Would you suggest withholding tax?

MR. KIRK: I beg your pardon?

COMMISSIONER BEAUVAIS: On the annuity?

MR. KIRK: I don't quite understand.

COMMISSIONER BEAUVAIS: Suppose the tax is $25.00 a month and the annuity is $200.00 then there would be a payment of $17,500.00.

MR. KIRK: It would be divided much the same way, in payments.

COMMISSIONER BEAUVAIS: That is all.

MR. STEWART: A resolution was passed by the Convention of the Ontario Federation of Agriculture since this was printed having to do with this subject and with the release of assets for operating purposes following the death of a taxpayer. At the present time bank accounts and all assets are frozen for a certain time and it creates operating difficulties, not only for the farms, but small businesses, I imagine, have the same situation. The recommendation from the Convention was that up to $10,000.00 be released for

operating purposes to farms and small businesses. This figure was arrived at on the basis that if the assets were under $50,000.00 or so there would be no tax acrued and if they were over that this $10,000.00 surely wouldn't be too much to release and it would greatly facilitate the operation of these farms and small businesses. This hasn't been introduced in the brief.

THE CHAIRMAN: Would you care to send us one copy of the resolution.

MR. STEWART: Yes, we could do that, sir.

THE CHAIRMAN: If you care to we will put it on the record.

COMMISSIONER BEAUVAIS: This would work if the three provinces adopted the same attitude.

MR. STEWART: Yes, it would have to be an agreement there.

COMMISSIONER BEAUVAIS: With the provinces.

MR. STEWART: Because, apparently, the banks are rather limited in their authority to loan under certain conditions and it does create problems of operation where business has to continue, wages and this sort of thing.

COMMISSIONER GRANT: You are aware that in the case of insurance or annuity that the insurance company can advance, now, I think it is $11,500.00.

MR. STEWART: Yes, where this applies, where there is insurance or an annuity up to the amount. In many cases this is not so.

THE CHAIRMAN: I shall move us on then to personal income tax. I observe that you make the

point that the farmer doesn't receive concessions in the measurement of income. You are taking the position that averaging is not a concession, it is necessary to the normal measurement of income having regard to the nature of farming. I think that is the point there?

MR. KIRK: That is right. I think, in so many other cases we would take the position, people in a similar disadvantageous position as a result of availability of their income we would think that they should apply in their cases too.

THE CHAIRMAN: As to losses, you have the same treatment as any other business, I think.

MR. KIRK: That is right.

THE CHAIRMAN: Why should you not conform with regard to depreciation? Why should you have straight line basis rather than diminishing balance as accepted by business generally and it is accepted by business because it is simple.

MR. KIRK: I think I will ask Mr. Stewart to answer this.

MR. STEWART: This, of course, came under serious consideration at the time it was brought into effect. It was brought in as blanket coverage and then farmers were exempt or given an option.

THE CHAIRMAN: I thought this was a concession to farmers at the time.

MR. STEWART: Well, it is probably a concession or recommendation on the nature of farm business and the nature of farmers, as much as anything. Farmers as a group like to pay as they go. They find

it very difficult to integrate the thinking of something which may come back later, such as recapture at a later date. They find it hard to integrate this into their thinking and business operations. This has been largely taken care of by the fact under Part 17 they are only allowed approximately half the maximum rates that are available under Part 11. This I think largely rules out any concession there under present circumstances. Now, there was a time, I quite agree, in 1948 following the war when farm machinery prices were on a very rapid rising market. This meant a lot to farmers. They were able to make capital gains that they might not otherwise have made.

THE CHAIRMAN: They escaped taxes.

MR. STEWART: I don't think this is so much the case at the moment as prices have sort of stabilized. Farm machinery does, in fact, deteriorate very rapidly. The more intricate the machinery gets the more rapid it depreciates. I feel that Part 11 is certainly a more accurate basis of assessing for depreciation.

THE CHAIRMAN: Part 11 being the diminishing balance basis.

MR. STEWART: Yes. Part 11 is diminishing balance. Speaking from a practical standpoint and from an administrative and political viewpoint the utilization of Part 11 requires a much more intimate understanding of the procedure as to what will be the ultimate effect of it. It would be very difficult to get farmers as a group into the position to understand it. It is much

simpler the way we have it now. If they want to stay on Part 17 they are only eligible to have approximately 50 per cent of the rates. Part 11 gives much wider flexibility in application, in the year to year application of adjustments of income, which I am sure you are aware of, than under Part 17. Part 17 is to a great extent quite restrictive but it is very simple and in the long terms effective.

THE CHAIRMAN: Half rate, you mean the rates permitted in the diminishing balance system by Part 11?

MR. STEWART: Maximum rates permitted in Part 11 are in most cases almost double.

THE CHAIRMAN: That, of course, equates reasonably back to the straight line.

MR. STEWART: Over a long period, but the year to year operations, it is much more flexible and does lend itself to excess depreciation, probably more so than Part 17. Part 17 at the present time, I don't feel lends itself to the taking of excess depreciation because the maximum rates are so low.

THE CHAIRMAN: I wonder if the farmers haven't reached the point now where they can conform to the rest of the country in respect of capital cost allowance, not that they are necessarily securing concession but they may be. They are certainly subject to be said that they are, because they are not having to meet recapture. Many people who are not farmers complain about recapture. It would seem to me that the capital cost allowance system isn't a complicated

system at all. When it was brought in it was brought in as an attempt to simplify, it not being there before. It was thought that the assessing and the record keeping would be reduced because of it because there was one balance required to be carried forward and not two, essentially. I think it has proven to be a successful simple way of proceeding to permit capital cost allowance. I would think if the only excuse for the farmers being kept out is they would find it hard to keep the records -- I can't see the difficulty in the records and I don't see the justification for it on those grounds and I don't see why they shouldn't pay tax on recapture the same as anybody else does. I think it should be the same, at the moment. I may change my mind. This is a recent judgment.

MR. STEWART: I think at the time it was in recognition of the lack of accounting policy and continuing records on the part of the farmer and it would make it very difficult for them to understand. At public meetings we have told farmers unless they felt they understood the implication of changing to Part 11, until they determined this is the thing to do they should stay the way they were because it was something they understood. You just need to think of the 250,000 or 400,00 farmers across Canada and the upset there would be in their thinking along this line. Actually I think again with the 50 per cent reduction of the maximum rate to a very great extent -- mind you I don't think it is unrealistic because certainly in our more complicated machines, self propelled machines and things

like that, the minute you turn the wheel you have achieved, probably, your 30 per cent depreciation. Under present circumstances under Part 17 which most farmers choose they can only take 15 per cent. Over a term of six or seven years they both balance out, but there isn't a great range and there isn't the opportunity of taking advantage under Part 17 that many people think there is.

THE CHAIRMAN: Thank you.

COMMISSIONER GRANT: Do you know of any instance, Mr. Stewart, where farmers have been allowed to change from straight line to capital cost?

MR. STEWART: Oh, yes. I am on it myself.

COMMISSIONER GRANT: You have adjusted?

MR. STEWART: We can change to Part 11 at any time, but once we change we can't go back.

THE CHAIRMAN: You change without permission?

MR. STEWART: You just take up your option to change once.

COMMISSIONER GRANT: Once you make your election that is it?

MR. STEWART: Yes. The only thing where this can apply - if I were under Part 11 and sold to a son or sold the farm like that, transferred it, then the other person could exercise the option which way it is going to be. It is not a continuing option.

COMMISSIONER GRANT: By the way, I looked at the Estate Tax Act and bank accounts are exempt immediately up to $1500.00.

MR. STEWART: That doesn't go very far. You

run into cases with cheques the taxpayer issued prior to his death that are not honoured.

COMMISSIONER GRANT: They wouldn't be if they were subject to payment after his death.

MR. STEWART: That can be quite a substantial amount.

COMMISSIONER GRANT: That has been the law for a long, long time.

MR. STEWART: I know. $1500.00 is pretty insignificant in the operation of some of these farms over a period of several months.

COMMISSIONER GRANT: Don't you find that the estate tax authorities are quite cooperative if there are funds in any sort of liquidity, making them available to you to convert them into cash?

MR. STEWART: We haven't found that. In a very limited experience, but a very recent one it is about five months and the bank account has just been released.

COMMISSIONER GRANT: I heard Mr. Linton who is administrator of the Estate Tax Act say they would never permit a hardship to arise if the Department, if it was in their power to cooperate or through cooperation to solve it. The local authorities have quite a bit of autonomy in that respect and I think that some of these hardships could be eliminated if the right approach is made.

MR. STEWART: Yes. It is probably a question of understanding that an approach can be made. Most people.....

COMMISSIONER GRANT: Don't know that they can?

MR. STEWART: When you start sending cheques back that have been issued by the taxpayer and recognize his due debt, when you start turning them back, people begin to think they are getting pretty tough.

COMMISSIONER GRANT: They will not turn them back. The bank will turn them back.

MR. STEWART: Yes.

COMMISSIONER GRANT: The estate tax authorities wouldn't do that.

MR. STEWART: Have you reason to believe that this sort of leniency applies at the provincial level as well.

COMMISSIONER GRANT: I have no experience fortunately of that.

MR. STEWART: Either one can tie it up.

COMMISSIONER GRANT: I am unable to say about that, Mr. Stewart.

COMMISSIONER BEAUVAIS: From what I can see in Quebec, they are very cooperative.

MR. STEWART: Provincially?

COMMISSIONER BEAUVAIS: Provincially as well as federally.

MR. STEWART: This is something that Mr. Blair should have been available to answer. I have very limited experience in that realm.

THE CHAIRMAN: Thank you. I think we have just about finished with income tax unless anybody has anything to say. We will move on to gift taxes, which

is a part of the Income Tax Act, at the bottom of page 24.

I do not think we have to explore the basic part. We have done so once before and the recommendation here is that it be retained. It is a sound method of measurement for tax purposes.

MR. STEWART: Yes. The recommendation here, Mr. Chairman, is that it be brought up to date a little bit. We are using a ten year figure here rather than 1947 in that the Health and Animal Branch are destroying records generally when they get ten years old. They keep their records current within ten years.

This is the reason for using this figure that they are the best records we have and the ones with which we work to establish basic worth.

THE CHAIRMAN: I don't think I have any comment on gift taxes.

Gasoline tax?

COMMISSIONER WALLS: I suppose your reason for gasoline tax is the fact that your use of gasoline and of diesel oil is particularly in machinery that is used on the farm and not on the highway. Secondly, there are quite a number of uses for gasoline and diesel oil that are already exempted with no more reason for it than perhaps for what you are asking.

MR. KIRK: That is right. There are certain exemptions, mining, I believe.

COMMISSIONER WALLS: Yes, and the fact that gasoline used by automobiles manufacturers for testing, all that is tax free and there are quite a number of industries that

use gasoline in their processing materials that are likewise exempt.

THE CHAIRMAN: The gasoline that is used in the farmers automobiles, that is fully taxable, I presume.

COMMISSIONER WALLS: That is right.

THE CHAIRMAN: How do they tell ---

COMMISSIONER WALLS: I think they tell by giving it a different colour.

THE CHAIRMAN: How is one to know the farmer doesn't put the wrong colour of gasoline into his car?

COMMISSIONER WALLS: Because the police stop and check the carburetors periodically.

THE CHAIRMAN: I am glad to hear it.

COMMISSIONER WALLS: Pardon me. I shouldn't be answering the questions.

THE CHAIRMAN: You seem to do it very well.

Net worth assessment. As far as I am aware, net worth assessments are only resorted to when the assessor cannot find a better way of doing it. It is the last resort. I do think they were used anywhere as a punitive measure because I have always thought that the Department was no more pleased with its use than is the taxpayer. It was only when the assessor found the taxpayer has not got a proper record of his income.

MR. BENTLEY: Mr. Chairman, in that regard, I think you are correct at the present time. A few years ago we know that they just periodically used to go through certain areas and take net worth assessments

of everyone. Now, they don't seem to be doing that. I don't know why they did it for a certain period of years but they certainly did it and they don't seem to be doing it to the same extent now probably because they, I think, have found these people are paying their taxes and everything was all right.

Certainly for a period of years this led to a great deal of discussion on the part of the farmers that this was not completely fair, that it was more punitive than anything else. I think it has been rectified.

THE CHAIRMAN: You think we have no further complaint.

MR. BENTLEY: We don't get them now anyway.

MR. STEWART: This was one field in which we had achieved a great deal of understanding and administered uniformly in application through the various approaches we have taken as a federation through newspaper publicity, public meetings and radio and that sort of thing.

Certainly we have had no resolutions in recent years whereas we used to have pages of them. We would have packed halls and great disruption of the farm economy through this procedure.

THE CHAIRMAN: You end up on a note with regard to tax evasion in your submission. I am not aware that one now thinks of the farm community as evading or avoiding or in any way getting away from their proper tax liability. I think at one time it was pretty hard to assess farmers because they didn't

write down the income but, as you have pointed out, most income is now accounted for because of the returns of the marketing agencies.

I might say there is no thought in anyone's mind that the farmers have any lesser sense of morality than the rest of the community. I have always heard that farmers are a little above the rest of us.

COMMISSIONER WALLS: I think it should be very clear that this was in answer to a questionnaire which was sent out by our staff which intimated that. That in no way represents the feeling of the Commission itself.

MR. BENTLEY: Thank you very much.

MR. KIRK: This was the only reason for it being included here. It was based as a suggestion.

THE CHAIRMAN: I am sorry about the question. It was actually an attempt to explore one area and even perhaps provoke you into an answer, which you have now given, which is a very good answer.

Now, that completes our questioning, I think, on your main brief, unless anybody here has anything to ask.

COMMISSIONER BEAUVAIS: I would like to ask a question. In Quebec I think the farmers have quite a sizeable income from the sale of pulpwood and lumber. You wouldn't know what proportion of their income is from that source in relation to their total income?

MR. KIRK: I am sorry I have none. I think it appears in the cash farm income statistics for the province. I do not recall. That is the trouble.

COMMISSIONER BEAUVAIS: Another question is in connection with property tax. Is it general in Canada that the basis for municipal evaluation is different with the farmer? It is much lower than the ordinary valuation. I know in Quebec it is much lower for tax purposes on your property tax, either school or municipality.

MR. KIRK: That the tax - I am sorry?

COMMISSIONER BEAUVAIS: Valuation.

MR. KIRK: Of the lands?

COMMISSIONER BEAUVAIS: Is much lower than for ---

MR. KIRK: City property?

COMMISSIONER BEAUVAIS: The ordinary residence.

MR. KIRK: That is the valutation of the residence or land.

COMMISSIONER BEAUVAIS: Both.

MR. KIRK: Well, of course, the value of the land would be lower. I think city property tends to be ---

COMMISSIONER BEAUVAIS: Much lower.

MR. KIRK: Yes, tends to be very much more expensive. They measure it by the square foot so often.

On the question of the value of the house, of course, the reason I find a little difficulty in responding exactly, I don't know -- I am not as familiar as I would like to be. I don't know, for example, whether there is a uniform basis of assessment between municipalities. This affects the position.

You could have a different assessment basis, of course, and a rate sort of adjusted to that situation.

COMMISSIONER WALLS: I could perhaps answer something about that because there are a number of the provinces which now have an equalization of assessments of like type of property for like purposes, so it would vary from province to province. It would be almost impossible to answer the question but what I presume is that working it out proportionately, the farmer is paying a great deal more as a result of being a large land owner than the urban citizen, even though the urban citizen's small acreage of land in itself may cost more per acre.

MR. KIRK: We feel it is an unsatisfactory tax. One interesting point in Quebec, sir, again L'Union C tholique des Cultivateurs have recently passed resolutions on this subject of property taxation and they rather opposed the use of property taxes as revenue sources on farm land and for commercial properties they recommend it be a provincial tax only, a provincial source of revenue only and not municipal.

One of the things about which they became quite concerned was the strong tendency for municipal competition in tax concessions to local industry. When such concessions were given they recommended it be at the provincial source.

When such were given these increases, they felt the farmer was bearing the load of this inter-municipal competition for special tax concessions for industry.

THE CHAIRMAN: Are you finished with this? I would like to move on to this other brief. We still have half an hour before lunch.

MR. STEWART: There is one rather interesting point. This principle has just been enunciated apparently. It just came out in this. It says "No allowance may be claimed on an automobile purchased after June 13th, 1963 at a cost of more than $5,000.00".

This is a new principle. It doesn't say that cost in excess of $5,000.00 will not be recognized. It just says that no allowance will be made. Now, I don't know whether this would get the position where we might say I can't pay more than $6,000.00 for a combine or I get no allowance. This is something that just comes to our attention.

THE CHAIRMAN: I doubt if we are really enunciating any principle. I would have thought that what this is attempting to do is not going to affect the farmers very much. This is an attempt, as I understand it, to get at expense account living. Of course, as you know, there has been a lot of difficulty surrounding that resolution.

MR. STEWART: I know it applies to all tax-payers but the fact is it doesn't allow any depreciation, as given out there, saying we would not recognize a cost in excess of $5,000.00.

THE CHAIRMAN: This is an attempt to say for business purposes you don't need a car of more than $5,000.00.

MR. STEWART: They could say the same thing by saying they would not recognize anything in excess of $5,000.00.

THE CHAIRMAN: I suppose if the Minister thought you were being extravagant by using a tractor that cost more than $6,000.00 because it had extra springs on it or something that you didn't need, he may similarly legislate.

MR. STEWART: Wipe out the whole thing.

THE CHAIRMAN: Or use cheaper tractors. I think that is only a principle.

Are you gentlemen prepared to deal with the Canadian Cooperative Wheat Producers Limited submission? There were certain parts of it which we did not hear before and this is your job, Mr. Parker, is it?

MR. PARKER: I will try. I have some help.

THE CHAIRMAN: I think we have covered almost everything that there is in here. I was going to go through rather quickly to see if there are any points which are different from what we dealt with or whether there was any purpose in discussing these points. I see there are one or two. I cannot see very many.

First thing I observe was on page No. 80, paragraph 133 at the bottom dealing with personal income your urge that a definition of personal income be amended so that personal revenue, which is really income but has been considered as investment capital gain become eligible for personal income tax.

Now, I must say I do not understand what you are getting at there.

MR. PARKER: Well, I think the proposition, is that some of our people suspect that funds which acrued to a taxpayer may in fact not be identified as income. I don't think I can go further than that. I see your perplexity.

THE CHAIRMAN: We have discussed it in the case of farmers already, have we not?

MR. PARKER: Yes.

THE CHAIRMAN: You are not talking about farmers, I presume, or perhaps you are.

MR. PARKER: The general proposition.

We raise this in the context of a side comment on capital gains. We rather disfavour taxing capital gains but I am not urging that.

THE CHAIRMAN: If I suggest that you were urging the desirability of taxing speculators, would that help out?

COMMISSIONER WALLS: I think you in fact state that specifically further on in the brief, do you not?

MR. PARKER: We mention the situation vis-a-vis security returns. We state that it is a gain from a security of some money only part of which is income. Part of which is improved in its face value. That is the sort of thing. This is the only instance in which we spell it out. We merely raise the proposition.

THE CHAIRMAN: Thank you very much.

Has anybody else any questions on the first part of this, which is pages No. 76 to 96.

If you not, I will move on to page 98, which

is taxation and taxes.

We will move on to pages 112 to 118.

On page 112 you comment on the desirability of the federal government undertaking a joint education campaign to acquaint farmers with the utilization of the five year averaging.

I am surprised that farmers have not found out about that yet. I would have thought that most of them know about it by this time. Am I not right?

MR. PARKER: I think they do, Mr. Chairman. I think they do. If they don't, it is their own fault. Our experience is the assessors certainly do comb districts. I was in a community three weeks ago where they spent two weeks solidly in one small community within a radius of 15 miles, half a day or a whole day with some farmers books. Obviously he discussed with him the principle of five year averaging. We find it particularly in the last few years the assessors are very cooperative in assisting him to pay a legitimate tax but to give him all the advantages that are prescribed within the legislation.

THE CHAIRMAN: I would feel is the best form of education the federal government could have.

MR. PARKER: It is. They go through the records -- the records are there. We get them out of our office. There is no opportunity for any misuse or that sort of thing. I find lately there is no resentment on the part of the individual farmer.

THE CHAIRMAN: Really.

MR. PARKER: This is good. There is a

change in the last five years to a considerable extent. Now the assessors are good. This didn't apply some years ago. I had occasion to write to the Minister about remarks made by assessors and it was straightened out. But remember income tax is relatively recent. The whole atmosphere has changed, at least, that is our experience, certainly in the Province of Manitoba. I think it applies in the two western provinces as well.

THE CHAIRMAN: It is very helpful to hear that.

COMMISSIONER GRANT: They have changed from being sleuths to being helpful assistants.

MR. PARKER: It didn't happen at the beginning. There was a certain philosphy and we very quickly got that straightened out. You go to the O.C. and get out of the Sergeant's Mess. You had to go to the top to get this straightened out and they became very cooperative.

MR. STEWART: There is one thing that does seem very funny, when you try to apply averaging in relation to the impact of provincial taxes -- I don't want to belabour you with the details of this but it is amazing what happens in using different sets of figures and trying to relate this on averaging with the provincial tax structure separated from the Federal, in most provinces. They attempted to correct it in this year's guide, but still funny things can happen.

THE CHAIRMAN: How many provinces now compute it separately?

MR. STEWART: In nine out of ten.

THE CHAIRMAN: Nine out of ten. Unless there is anything before this I am going on to page 113 with the heading Estates Taxes. You say at the bottom "Our fear remains as expressed earlier in this submission that economic farm units, which farmers in the west are attempting to establish by every means possible, may be threatened by death and succession duty requirements". Is there any evidence that has, in fact, occurred?

MR. PHILLIPS: I don't have any evidence. I would like to add to what you have said. It is not simply the physical size. We are speaking also of capitalization of equipment and other things. I don't have any evidence. We are told continuously this is a great fear. That is, of course, by people who are living and haven't faced the problem.

THE CHAIRMAN: I have no further questions. Does anyone else have any? Well, this has been a most interesting morning. I suspect all of us have got a much better understanding of the farming community in our country and your problem. I thank you very much indeed for this very good submission that you have made to us and for the helpful answers. We will certainly do our best in our considerations of this. You have left a few problems with us, I must say. It wouldn't be any good if you hadn't. Thank you very much, gentlemen.

MR. BENTLEY: Thank you very much.

THE CHAIRMAN: Mr. Secretary, is there anything further?

THE SECRETARY: That is all for this morning. Tomorrow moring at 9:30.

THE CHAIRMAN: We will stand over until tomorrow morning at 9:30.

---Whereupon the hearing adjourned to 9:30 o'clock a.m., December 10th, 1963.

ROYAL COMMISSION

ON

TAXATION

HEARINGS

HELD AT

OTTAWA

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THE ROYAL COMMISSION ON TAXATION

Hearing held in the Centre Court Room, Exchequer Court of Canada, Supreme Court Building, Wellington Street, Ottawa, on Tuesday, the 10th day of December, 1963.

C O M M I S S I O N

MR. KENNETH LeM. CARTER — CHAIRMAN

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MR. A. EMILE BEAUVAIS

MR. DONALD G. GRANT

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RESEARCH DIRECTOR

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SECRETARY

MR. G. L. BENNETT

* * * * *

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* * * * *

Tuesday,
December 10th, 1963.
Ottawa, Ontario.

---Upon resuming at 9:30 o'clock a.m.

THE CHAIRMAN: Mr. Secretary, if our visitors are ready I think we might as well get going.

THE SECRETARY: Good morning, Commissioners. The first brief this morning is being presented by the Canadian Bottlers of Carbonated Beverages. You have had the brief before you for some time and this morning there are a group of gentlemen from the industry who will speak to the brief.

Mr. C.W. Floody, Executive Director of the organization will say a few words and introduce his colleagues. Mr. Chairman, I would like to enter this brief into the record as Exhibit 284.

SUBMISSION OF CANADIAN BOTTLERS OF CARBONATED BEVERAGES

APPEARANCES:

Mr. Francois La Pointe,	Vice-President of Canadian Bottlers of Carbonated Beverages and President of the Quebec Bottlers of Carbonated Beverages.
Joseph A. Whitmore,	Chairman of the Legislative Committee of the Canadian Bottlers of Carbonated Beverages.
William Latimer,	Counsel for the Canadian Bottlers of Carbonated Beverages.
C.W. Floody,	Executive Director of the Canadian Bottlers of Carbonated Beverages.
H.E. Woolley,	Treasurer of the Canadian Bottlers of Carbonated Beverages.

William Emerson, — Member of Legislative Committee of the Canadian Bottlers of Carbonated Beverages.

Mervin Mirsky — Member of Legislative Committee of the Canadian Bottlers of Carbonated Beverages.

EXHIBIT No. 284: Submission of the Canadian Bottlers of Carbonated Beverages.

THE CHAIRMAN: Thank you, Mr. Secretary. Good morning Mr. Floody. I would be grateful if you would start by introducing your associates to us. For my part I introduce to you the Commission whose names are before us here. We have read your submission. There is no need to again read it. We will have a few questions to ask you. If there is anything you would like to say to us before we get to our questioning by all means do so.

MR. FLOODY: On my right is Mr. La Pointe, Vice-President of the National Association and President of the Quebec Bottlers Association. Next to him is Mr. Whitmore, who is Chairman of our Legislative Committee. Next to Mr. Whitmore is our counsel who will have a few words to say on our brief. On my immediate left is Mr. Woolley, the Treasurer of our Association. To his left is Mr. Emerson from Montreal, a member of our legislative committee and Mr. Mirsky from Ottawa, also a member of the committee. If I may I will ask Mr. Latimer to make a few comments on the brief.

THE CHAIRMAN: Thank you, Mr. Floody.

MR. LATIMER: The brief as you have read it is relatively short and we feel we can to some extent

explain matters which have been raised in it. We make reference particularly in describing the industry to recent Government statistics and we, of course, refer to the 1961 Dominion Bureau of Statistics. I think it is interesting that this industry is spread directly across the country from one coast to the other and that a very large number of the establishments are what you might regard as small employers in small towns. The total employees which we haven't recorded for you is about 7,800. We also think is important the impact we have on the Canadian economy generally -- that is our costs that are absorbed in the Canadian economy. A substantial one of them, of course, is sugar. The Bureau of Statistics in dealing with the sugar industry indicate that we purchased in 1960 approximately 180 million pounds of sugar which is substantially the largest consumer of sugar. We think that has a great effect on the sugar industry in Canada. We regret the unstability of the sugar prices at the moment. We incur substantial costs in Canada, for example paper products, cartons and labels, etc. which in 1961 were approximately $9,600,000.00 odd. Glass bottles more than eight and a half million. Wooden cases -- there is a very limited manufacture of wooden cases. There used to be a fairly large number but now they are supplied substantially to this industry and our purchases in that in 1961 were almost $2 million. We also purchase between four and five thousand commercial vehicles a year.

With respect to the principles of taxation I am sure you have observed that we have confined ourselves

primarily to the question of sales tax. Our concern, of course, with sales tax, as you can see from the brief is that it puts us in a disadvantage with competitive products in the commercial sense. We feel that there may have been many years ago the idea of separating carbonated beverages from other kinds of beverages, but consumer habits now indicate more than 70 per cent are consumed in the home and places us in a completely competitive position with other beverages such as tea, coffee and so on. I feel that this trend is so marked that in the October cost of living index in the middle of the market price increase referred to which include milk, cheese, bread and other cereal products, soft drinks, pickles, most fats, etc. We seem to be included in every way except the exemption from this federal sales tax. We compete with those products as the brief indicates in almost every way in which we market our products. I think it is also interesting that the character of our business is such that it is almost exclusively locally owned by local businessmen which, I suppose, isn't true of most of our competitors. Thank you, sir.

THE CHAIRMAN: Thank you, Mr. Latimer. Before getting to taxes I have always observed, I think, that bottlers are small independent companies. What you tell us bears that out. I notice the average number of employees is about 16, dividing 7800 by 502 bottlers. Are there any soft drink producers, companies that manufacture the product that do their own bottling?

MR. LATIMER: Yes. I think Mr. Whitmore perhaps would answer that better than I. He is closer to the industry.

MR. WHITMORE: Yes, I think Mr. Chairman, Members of the Commission, we make the point on the first page to clarify that, that of the some 500 bottlers there are about 45 which are owned by what are called major franchise houses. Of the some 500 bottling plants in Canada there are approximately 45, not more than this, owned solely and handled by the major franchise companies. All the other companies are independently owned, provide their own capital and either operate their own brand or under a franchise arrangement from one or the other of the major franchise companies.

Any place, Kenora, Moose Jaw, North Battleford, if you will, the bottler has solely got the responsibility for his financing, purchasing, etc. He may bottle in addition to his own bottle range, or whatever it may be, he might be franchised for a local house. At all times he is autonomous in the local community and responsible for his financing, sales and operations.

THE CHAIRMAN: Are those 45 bottlers all owned by the same major company?

MR. WHITEMORE: No, it is spread over all of the major companies.

THE CHAIRMAN: A lot of the major companies will own one, two or a few numbers of bottling establishments.

MR. WHITMORE: That is correct, in various sectors.

THE CHAIRMAN: Why do they do that? Why wouldn't they stick to licensing of the bottlers which is the general practice? Why should they own a few bottling companies? Are they people who got into trouble and they got them out?

MR. WHITMORE: As I observe, and I was formerly managing director of the Association, we have to go back into the history of the business at which time some of the major companies established themselves either in Toronto, Montreal, Winnipeg or Vancouver and so on -- all those since have established their own companies. As time went on of course business developed and more and more franchised bottlers, and I know of no more than three or four occasions where a major company has purchased a local company, occasions that I am aware of. This would be where this local company was formerly franchised but I think in the main our industry has been stable in that the number of franchised companies who had these some 40 outlets have maintained them for a great number of years.

COMMISSIONER WALLS: Following up that question I suppose that the 10 per cent of the large companies possibly represents about 80 per cent of the sales?

MR. WHITMORE: I can't give you an exact figure but I would say it is far from being correct. It wouldn't be nearly 80 per cent. I don't know if Mr. Woolley would have any idea but I don't have the figure, and I don't think we have got one. It is far

short of that. Mr. Woolley, would you have any guess about that?

MR. WOOLLEY: No. We have no statistics available to support that, but I know from experience in this industry for a number of years it wouldn't come even close to 80 per cent, not even close.

THE CHAIRMAN: When we are talking about large companies are we talking about ten or twenty?

MR. WHITMORE: We are talking about five.

THE CHAIRMAN: Five, yes.

MR. WHITMORE: About five, yes, sir.

THE CHAIRMAN: Sugar is something which you consume a great deal of and you make a point you are substantial contributors to the sugar industry.

Sugar is a product that is very largely imported into Canada, I would assume. I do not know what proportion of our quota is produced in Canada but the sugar beet industry ---

MR. FLOODY: About 18 per cent, sir. Eighteen to 20 per cent is produced by the sugar beet industry.

THE CHAIRMAN: Moving to taxation in paragraph 7 of your brief you speak of some general principles of taxation such as ministerial discretion, simplicity and the minimum effect on business decisions. You are referring to all taxes, I suppose, not just the sales tax.

MR. LATIMER: That is correct, Mr. Chairman, all taxes.

THE CHAIRMAN: You do not particularly wish to develop that, I don't suppose. Those statements that

you make are, I think, made by most people that appear before us.

MR. LATIMER: Right, sir.

THE CHAIRMAN: I do not know if there is anything you would like to add to that statement.

MR. LATIMER: We only placed it in our brief because we did consider that they are fundamental principles of taxation. We are directing our brief primarily to the question of sales tax on this product.

THE CHAIRMAN: We get into your problems in paragraph 8, I take it?

MR. LATIMER: That is correct.

THE CHAIRMAN: You indicate "the last and perhaps the most important point we support is that taxing statutes should not discriminate. In our view it is quite wrong to place one industry at a tax disadvantage as compared with the manufacturers of other competitive products".

MR. LATIMER: We do not suggest that this tax was imposed as a deterrent. It has a deterrent effect.

THE CHAIRMAN: I think the very import of what you say is that "one industry standing in competition with another should bear exactly the same burden of tax".

Now, you compete with a lot of industries. I see you say tea, coffee, hot chocolate and so on.

I also assume that you compete with candies in a general sense, which are taxed and I am wondering whether you would in fact not compete with beer and wine

and alcohol, which are very heavily taxed.

MR. LATIMER: I think we do not consider that we compete with beer, alcohol and wine. We would consider those beverages to be a different category.

THE CHAIRMAN: I must say I would too. I am wondering whether the choice is not very often made as to whether one consumes something alcoholic or a soft drink. I have found myself making that choice very frequently.

MR. LATIMER: I think it is conceivably so. Although we have no figure to support it, I would expect that the area of competition is extremely limited.

True, some people make that choice occasionally but it is not the source from which our prime competition comes.

THE CHAIRMAN: They must be making a choice between your product and ice cream and popsicles and all these various things.

MR. LATIMER: That is right.

THE CHAIRMAN: Ice cream is tax free.

MR. LATIMER: That is right.

THE CHAIRMAN: Popsicles are tax free.

MR. LATIMER: Yes.

THE CHAIRMAN: Candies are taxable.

MR. LATIMER: They are, sir.

COMMISSIONER WALLS: It seems to me, going over first of all what you said as to products that compete with your products. You spoke of hot chocolate. Of course, there is a large list of foods that are taxable.

Looking it over it seems that it takes into consideration foods which are high in sugar content. In other words, such items as Candy, syrups, jelly bases, jam bases and topping for ice cream. All of the contents, if you go over the list, are those that are high in sugar. I am wondering if that is the reason you have been kept in that particular class and for the particular reasons that you were kept in the excise tax up to 1957 also.

MR. LATIMER: Well, we cannot give any specific reason as to why we are there. We think it is a source of revenue to the revenue and we believe that is the only reason we are there.

Of course, the product with the absolute maximum sugar content is not taxed, that is sugar itself.

Our content of sugar is estimated at an average approximately of 10 per cent of our product, which does not sound like a very particular high sugar content.

COMMISSIONER WALLS: I am also wondering why you compare your product particularly with tea and coffee and hot chocolate and so on because it seems to me there are a number on the taxable list that you may be much closer to, fruit drinks that do not contain 85 per cent pure fruit juices are taxable.

MR. LATIMER: Yes.

COMMISSIONER WALLS: Bases or concentrates for making soft drinks are taxable.

MR. LATIMER: Yes.

COMMISSIONER WALLS: Apple-cot, orange-cot,

apricot nector and peach nectar are all taxable.

MR. LATIMER: Yes.

COMMISSIONER WALLS: So I mean if you are going to make comparisons between your product and tea and coffee, it seems to me your product would perhaps more closely rival each of those I have just mentioned than it would tea and coffee.

MR. LATIMER: I would like Mr. Woolley to speak on this. Traditionally we have been attempting to draw our comparison with tea and coffee. We think the quantity consumed, the way in which it is consumed and the place are all identified with meals as such that we are in direct competition with tea and coffee, but I would like Mr. Woolley to say something about this question.

MR. WOOLLEY: First of all, Mr. Chairman, to get into this subject, it is quite a comprehensive subject. I personally have been following it. I have been around this world a little while. I have been following it and it seems when some of these taxes were put on there were personal preferences entered into it. We used to be basically a tea and coffee consuming nation. Today the complex of this country has changed immeasurably particularly in the larger cities where people living there, I don't suppose they ever pass tea or coffee through once a year. People all over buying soft drinks we feel are penalized for that.

In some of these cases the regulations are archiac today. We need to take a good look at them and get them into line. Other people that are living

here have other preferences.

Talking about fruit juices where there is a provision for 85 per cent of content, certain fruit drinks would come under that category.

On the other hand we are talking basically about carbonated beverages. They are used far more widely for straight consumption of liquids and they do compete -- tea and coffee and things of that kind do compete with these drinks. Today the complexion of our population has changed; not only the habits but let us call them racial preferences.

All you have to do if you really get into the subject is to go down some of the streets in some of our cities and there are places where very little tea or coffee goes on that street. Therefore soft drinks are used for meals. It is not just a matter of refreshment. They are used for meals. It is an ever increasing amount. Whether that answers your question, I don't know but it does indicate we should keep pace with the change, this change of the last few years.

COMMISSIONER WALLS: I would agree with you that the whole matter of food exemption has to be revised. It is rather hard to understand why some are taxed and some are not. Maybe they should all be taxed. I am not sure about that at all yet.

Supposing that the 11 per cent sales tax was taken off carbonated drinks, would the saving be passed on or would you still ~~not~~ charge the consumer ten cents a bottle?

MR. WOOLLEY: That is something that is very difficult to answer through an association for the industry because every company is independent. How they price their merchandise is their business.

As a personal opinion I would say that some of us may pass on some of that but there would be other instances where there is a run down plant and so on, they might reinvest some of the savings to get a better operation. More employees and any tax loss, I feel sure, a good percentage of it would still end up with the government.

COMMISSIONER WALLS: Do you not think that that is the crux of the whole situation. From your industry today we get the $13.4 million in/taxes, from the carbonated beverage industry.
sales

MR. WOOLLEY: We want to be factual with you. I think it was wrong for me to say we would drop our prices because afterall prices are something that is private to a company and set by that company. They are not controlled by an association.

Therefore, it is the most difficult for me to comment on but I would say that other companies would take a look and do some re-budgeting and so on. In our

industry they may expand by more help, for instance, and better facilities and things of that nature which all contribute to the economy and very time you put an employee on your payroll or give him a raise there is income tax goes along with it for the government. If they don't get it one way they are going to get it another way.

COMMISSIONER WALLS: Yes, that is our problem.

THE CHAIRMAN: What happened, Mr. Woolley, when the excise tax was removed in 1957? Were prices in your industry reduced?

MR. WOOLLEY: The last major tax we had reviewed, that is the one you are referring to?

THE CHAIRMAN: Yes.

MR. WOOLLEY: We were just on the point of having to increase our prices. What it did was to be able to hold the line for that price.

As a matter of fact, I think you will find the industry travelled pretty well on that price structure until this year; pretty well on this price structure, which is a long time and which was quite a feat.

THE CHAIRMAN: The price has gone up this year.

MR. WOOLLEY: Yes.

COMMISSIONER WALLS: Thank you very much.

MR. LATIMER: There is an interesting story of the excise tax and the sales tax, by examining the quantity and value of production in the years in which these taxes were imposed; subject to one period when

sugar rationing was suddenly imposed.

You will find there appears to be a very direct relationship to the quantity and value produced and sold as these taxes were varied.

We have some figures, for example. The tax was removed in 1956 and the value of production jumped from $107 million to $123 million the following year. There are illustrations like that throughout the D.B.S. statistics of the procedure of this industry.

THE CHAIRMAN: Mr. Latimer, I marked my copy to the effect that there didn't seem to be much evidence supporting what you are putting forward. I was thinking of such statistics as you have mentioned.

MR. LATIMER: Yes.

THE CHAIRMAN: I wonder if there were any facts which would indicate what the effects would be in tax changes. You are now telling us there are. It seems to me this is one of the most important matters.

MR. LATIMER: Perhaps if I could hand you a copy of the 1939-1961 statistics, page 12.

THE CHAIRMAN: Thank you, Mr. Latimer.

MR. LATIMER: The 25 per cent excise tax was imposed, I think, originally in 1941. There was an eight per cent sales tax and you will note that there was a half million dollars drop in the value of production the following year.

The following year in 1942 it was retained at 25 per cent, plus one cent per bottle and there was very little change in the production in the year which followed.

There was a gradual increase as that tax remained constant except for the period 1945-1946, which was the year of sugar rationing and then in 1948, on March 20th, I believe it was, 1948 the tax was removed.

You will note that production went up from $57 million to $73 million.

Then in 1950 there was a 30 per cent tax imposed and there continued to be an increase in production but in 1952 it was reduced to 15 per cent and there is an increase there of $12 million over the prior averages.

In 1954 it was further reduced to 10 per cent and there was a $11 million increase.

THE CHAIRMAN: Excuse me. Did you say 1954?

MR. LATIMER: 1954, sir.

THE CHAIRMAN: In 1954 I see a reduction in value and reduction in quantity.

MR. LATIMER: I am referring, sir, to the following year which would reflect the results of the reduction.

THE CHAIRMAN: I see.

MR. LATIMER: In 1956 that tax was removed and there was an increase of $16 million.

Now, we cannot, of course, say that all these things are the direct and only effect of tax changes. It produces, I would suggest, an interesting picture, as it were.

THE CHAIRMAN: Well, to recover the amount of excise tax which, I presume, is something over $10 million -- sales tax was $13 million.

MR. LATIMER: Yes.

THE CHAIRMAN: It would require a very substantial increase in volume, would it not, to recover that out of income tax.

MR. LATIMER: Well, it will require some. The immediate effect would only be a loss of half of that amount, assuming that this industry is profitable and then, of course, the industry is always attempting to expand its position to provide a better relationship which requires more employees and which requires further tax deductions.

We cannot insist that there would be no tax loss but we believe that -- quite honestly believe -- it would be a very minimal amount.

MR. WHITMORE: If I may make an observation, Mr. Chairman, on the point Mr. Walls spoke of. You mentioned our competition. From experience I feel we are quite sensitive to price changes. Formerly we used to refer to this as the nickel field. When you are in the nickel field, which included all these things such as candy, chewing gum, popsicles and life savers, if you increase your price by one cent -- it cannot be less than one cent, it has a tremendously deterrent effect upon sales.

I think we have said in our previous brief to the Finance Minister, this industry tries and always has to present its products in the market place for the lowest possible price, because if we do not do that, we find ourselves in a very tough position competitively with all these other things that are in the market today.

If you were to go into a supermarket today and take a look at the beverage section it is just tremendous over what it used to be. At one time if you went into a store you looked at the three or four or five brands and you had covered everything. At the present time there are more and more so we feel we are intensely sensitive to this question of price increase and the industry historically has always kept the price as low as it could possibly get in the market place, to the point where many times it has been absorbing losses in order to stay competitive. We think this is being practical in the market place, where we have to live.

COMMISSIONER WALLS: You mentioned you are competitive with chocolate bars and gum, both of which are taxable and both of them face exactly the same hazards of an increase in the sugar price as your products do.

MR. WOOLLEY: That is right.

COMMISSIONER WALLS: You also mention in your brief quite a large percentage of your business is marketed through vending machines. When you do that I presume that your product practically has to be sold in even nickels. This is so as to operate existing vending machines where there are no provision for cents in change.

So the question is: Then what happens in the case of another increase? Let us say the sugar price goes up and you do not get this 11 per cent taken off. You either have to maintain your vending machine prices at 10 cents or increase it to 15 cents. Am I right?

MR. WHITMORE: I think I may qualify that in this way. We have been studying it slightly. I am

not a mechanic at all. I am told by the mechanical people that there are certain things you cannot do in change.

You can, for instance, have an 11 cent mechanism, a 12 cent mechanism, a 15 cent mechanism. I do not think you can have 13 or 14 or 16 or 17. It is possible to have a price of 11 cents or 12 cents or 15 cents. I think what you might find in there might be some variation in the size.. It might be 15 cents but it might be king size versus regular size which might be sold at 10 cents. I think market wise this would equate itself too. Wherever a soft drink company can sell at lower prices it would want to do so and it will want to do so.

COMMISSIONER WALLS: I notice you don't question whether it can be turned out for nine cents. If we take the tax off we would naturally assume it would go to the consumer and, perhaps, you should have been investigating whether you could now sell in vending machines for nine cents.

MR. WHITMORE: If the industry can sell at five cents and make a profit I think the volume would sky rocket and we would be happy, if we could sell at a profit.

THE CHAIRMAN: If the vending machines wouldn't work at 9 cents would that regulate the entire price? Would you have to keep your non-vending machine prices the same as your vending machine and thus leave them all at 10 cents?

MR. WHITMORE: I don't want to state, Mr.

Carter and gentlemen it can't work at nine cents. Anything can be made to work. I know from investigation there are certain figures that will work more easily than others. This doesn't preclude going to nine cents or any other price. It is just some things work a little more easily than others.

COMMISSIONER PERRY: I wonder if the vending machines are important since you say 70 per cent are sales are for home consumption. I read this as implying you are now in a mass merchandising industry, competing not on a unit basis but on a bulk basis through mass merchandising. Am I right on that? I know where my wife buys her soft drinks.

MR. MIRSKY: There is one aspect, I don't know whether the rest of the Committee will entirely agree with me, that is the situation in Canada, we have certain industries which are subsidized or semi-subsidized by the Government, let us say the mining with large liabilities, which have certain concessions and so forth. In our particular industry one of our competitors, the dairy industry, and I don't suggest that you tax or untax the dairy industry, but at the moment the dairies in addition to producing milk products are producing orange-ade and lemon-ade. This is a fairly recent development. They are delivering right to the homes, selling a product precisely the same as our product. They are not subject to any sales tax. This makes very difficult competition for two reasons, one it is delivered right to the home and secondly they are not subject to sales

tax.

COMMISSIONER PERRY: I was really questioning how relevant the discussion based on per unit price really was any more when it looked to me as though most of your increasing sales were on a carton basis with which you might have quite a bit of keen price competition.

MR. LATIMER: Our prices are highly competitive in particular areas in this field. The reference to the vending machines was to illustrate another method of marketing, which is common both to ourselves and to our competitors that don't bear the tax. Similarly our reference to servicing eating establishments and restaurants of every description again is to illustrate how we compete with non-tax products. We don't intend to indicate that our sales at the moment in vending machines are that substantial when over 70 per cent is home consumption. We couldn't maintain that they were that substantial. I am not sure we have any particular figures on what sales are in vending machines.

MR. WHITMORE: I was going to bring this into proper focus. We are talking about a relatively small section of the overall business through vending machines. I think, Mr. Perry, that is important to look at, perhaps we should have mentioned, in the question of prices you are mentioning you do get into the bulk field, in the same bottles. We do have 70 per cent home consumption. Recently it has been bottled in cartons and now cases are coming in. At the present time some major companies advertise cases during

the Christmas period, for example.

COMMISSIONER WALLS: I think the reason the Chairman and myself were interested in the price you put on the vending machines was to know to what extent the vending machine price would have a bearing on your whole product -- sold outside of vending machines.

THE CHAIRMAN: Not very much I am assuming from what you said.

MR. WHITMORE: The assumption is correct.

THE CHAIRMAN: There was one thing Mr. Mirsky said I didn't quite understand. I think he told us that the dairies sold soft drinks, and when they sold soft drinks that these drinks weren't subject to sales tax; is that correct?

MR. MIRSKY: Yes, that is my understanding.

COMMISSIONER WALLS: That is pure fruit juice they sell with no tax.

MR. WHITMORE: I think it is 85 per cent juice of the fruits.

THE CHAIRMAN: Thank you.

MR. WHITMORE: In all other respects they would be taxed.

COMMISSIONER GRANT: At the time the exise tax was removed from the soft drinks I seem to recall that that was as a result of strong representations which the industry made to the Government based upon the fact that costs were increasing, that it was impossible for you to put a product out and to compete with other products such as ice cream which wasn't subject to tax without either reducing the size of your bottle, which

I suppose would have caused more expenditure to the industry.

MR. WHITMORE: That is right.

COMMISSIONER GRANT: Would I be right in saying that the Government listened to the representations and gave you this relief by removing excise tax?

MR. WHITMORE: May I answer that, sir. We happen to have in our file a copy of pages 22, 25, Hansard, March 14th, 1957. The Hon. Mr. Harris was the Finance Minister at that time and he said and I quote: "I have always been impressed with the increased difficulty which hundreds of small soft drink bottlers appear to be facing from coast to coast. I trust the House will approve my decision to act now in removing the special tax on soft drinks." This is a direct quote from the Minister. It is extremely interesting to note at that time they also removed tea and coffee and a number of other things from the sales tax.

I appreciate what you said, Mr. Grant and it leads into another very short argument, and that is our industry has always been in a different position than some of our competitors with regard to our packaging. In other words we have 6½, 10, 12 ounce bottles and at no time would we consider putting 4 and 7/8 ounces into a 6½ ounce bottle to equate the price. I think it is fair to say that this isn't the situation in some of our direct competitors whereas you remember there were certain articles during the prior excise tax period which was shrunk in size to maintain the price. This is something, I think, that remains peculiar to us.

We have gone along with the standard type of container volume-wise and we have always had to merchandise that in the same way and not shrunk our package or shrunk the contents.

COMMISSIONER GRANT: Paper packages will permit variation. The bottle doesn't.

MR. WHITMORE: Paper, foil, aluminum foil but different kinds of bottles will not permit that because it is a very substantial investment.

COMMISSIONER GRANT: Isn't your problem to day the fact that you have never been able to get the government to accept your product as being food.

MR. LATIMER: Well, sir, we have had it accepted as a food, but not as a food which is exempt from tax. The result is we are just as unhappy, of course.

COMMISSIONER GRANT: I would like to ask as to the state of the industry as a whole. Are you suffering as an industry in Canada?

MR. LATIMER: This is difficult to project, really, because the individual state of each member of our Association is not made known directly to us. We only know that certainly in 1957 we understand that representations were made and figures were disclosed to the Minister by individual bottlers which indicated that the number of establishments is gradually declining in an area in a time when you normally expect the numbers to increase. We think it is an effective point to the situation that the small 475 bottlers are having a difficult time.

COMMISSIONER GRANT: It would just be a matter, to my own observance, that when the beverage industry was in the hands of the small operator and he developed his own brands and sold it under his name that there used to be a lot of competition and a lot of bottling plants and there used to be quite a number of failures but that in, say, the past ten years the industry has undergone a change. There are fewer bottlers. While some do carry out their own process and formulate and bottle and sell their local market with their own beverage yet they are, very often I think as you pointed out earlier tied in with national organizations whereby they receive their sugar in bulk and doing their own packaging and sell under brand name be it Coca-Cola, be it 7-Up, be it Orange Crush or whatever it is. Those are three of the big five, are they?

MR. FLOODY: Yes, sir.

MR. LATIMER: Yes.

COMMISSIONER GRANT: Today the industry from my observance would be in a much better financial condition as a result of this support which they are now getting from the big five whereas the big five at one time were in direct competition with them.

MR. LATIMER: Yes. Mr. Woolley, perhaps you would like to comment on that.

MR. WOOLLEY: Mr. Chairman, Mr. Grant, I think a great many of the things you said, that we have to agree with you. On the other hand this industry is a lot like other industries faced with rising costs.

I believe that these franchise drinks you are speaking of, I think does help the bottler immeasurably to keep his costs down. On the other hand I believe, and I haven't checked, I think I am right, if you check D.B.S. statistics it will show over the last several years there are fewer numbers of bottling plants each year. I know we have a saying in the industry paraphrasing General McArthur that bottlers, they don't fail, they just fade away, they don't die, they fade away. They just pay off what they can and go out of business.

COMMISSIONER GRANT: I think you should attribute that to Kipling rather than McArthur.

MR. WOOLLEY: Nevertheless this is the type of business if a man can't support himself he just goes out. There is nothing spectacular; it is never a big one. This has been happening in the industry, the franchise companies, they give great help, particularly in research. They don't furnish any cash but they help in research and things of that nature. That is actually what was going on in this industry. It is no simpler to operate this industry today than it ever was. It is just as complex and highly competitive.

MR. WHITMORE: Mr. Chairman, Mr. Grant, I have been in the industry myself since about 1943, and while I cannot support this statement I am going to make with any evidence I can support it through very long experience with the business and I would say first of all we should not give you the impression that the bottlers are dropping like flies. That isn't so. We perhaps lose three, four, five bottlers in a year.

We have the figures. In 1958, for example there were 537. In 1960 there were 514. The loss is relatively small. It is an important one. I would agree with Mr. Woolley, that, in fact, it is harder for a local bottler to operate now than it was before because he is faced with mass merchandising, different methods of distribution, new products, different kinds of products and different ways of merchandising them, large marketing stores, large supermarkets and so on. I would say that the bottler now is having, perhaps, a more difficult time to make a profit, the average bottler is having a more difficult time to make a profit. I can assure you of this. I go back to the brief, our members must be competitive but with rising costs of all kinds it is becoming more and more difficult for a bottler to make money at the present time.

I think Mr. Mirsky will suport that, and so will Mr. Emerson.

COMMISSIONER GRANT: I think there is another factor peculiar to your industry, that is that your sales are influenced considerably/by the climate.

MR. WHITMORE: Yes, sir, they are.

COMMISSIONER GRANT: When we have a good summer, warm summer or early summer then sales soar.

MR. WHITMORE: Yes.

COMMISSIONER GRANT: Sometimes a wet summer, a cold summer will be the difference between profit and loss to the industry and sometimes in the case of a small operator it could mean that he just can't stand too many of these bad summers.

MR. WHITMORE: It has been said that the sun is our best salesman. This is right. There is one fact, it is changing. There was the time when the bottler had a tremendous sale in the summer time and then he went along and then Christmas came along and he had a pyramid at Christmas and it went down to June. Because of the change in the buying habits we are leaving this. I don't suggest it is the same for twelve months, but it is leveling out which is a source of satisfaction to us, that our product is accepted in homes and taken home irrespective of the weather. If the product taken home is 70 per cent obviously this situation of peaks and values is lessening. We are happy to see it is. You are quite correct in saying that the weather is a good stimulant to our business, or a great deterrent.

MR. WOOLLEY: It is our plus business.

COMMISSIONER MILNE: I was going to ask Mr. Whitmore a question about home consumption. I was interested in this particular part of the brief. You mention that at the present time about 70 per cent is for home consumption. What would be the percentage from which this rose, what previously might have been the percentage of home consumption?

MR. WHITMORE: There has been quite a radical change and I can't tie it down to years. I would say, Mr. Floody, in a matter of three, four years ago we were talking about sixty to fifty-five per cent. Now we almost try to present a conservative figure to you. Some companies are doing more than 70 per cent, some a

little less. Seventy per cent is now about level and we are merchandising in a different way than we used to.We think this figure will increase. You have seen a rapid change in the past five years, and definitely in the last ten years.

MR. FLOODY: I would say in the ten years I have been associated in the industry -- we started to say 50 per cent when I came into it and now we are talking about 70 per cent so there is 20 per cent in ten years.

COMMISSIONER MILNE: I would think in ten years it would be a reasonable figure.

MR. WOOLEY: As a matter of fact twenty-five years ago my guess is it would have been 15 per cent home consumption, twenty-five years ago. Most of the stuff was consumed in little coolers at the corner store, things like that. Persons might be known to buy a couple of bottles or a quart and take it home in a bag. I don't suppose over 15 per cent at that time was home consumption. It is used in cooking, in meals and so on. That is where the consumption is.

COMMISSIONER PERRY: I have one question: Are the lower calorie drinks regarded as a big thing in the industry? Will it represent a substantial change?

MR. MIRSKY: It is a fairly new development. I think it is too soon to say. At the moment in spite of the introduction in certain markets I wouldn't think they represent even one per cent of the total soft drink in Canada.

COMMISSIONER PERRY: What does the product represent in change in your costs? Are these more or less expensive?

MR. MIRSKY: When sugar was approximately $8.00 per hundred -- it is today approximately $10.00 per hundred. When sugar was $8.00 the cost was just about the same. The artificial sucural and saccarin used in the other drink cost the equivalent of the sugar when the sugar cost $8.00 a hundred weight. Now it is less because of the increase in the sugar.

COMMISSIONER WALLS: With respect to this sugar price, I note in the part of the country I come from quite an increase in importation of soft drinks in cans. Is the lower sugar price in the United States making it harder for you to compete with imports?

MR. MIRSKY: No, because the canned soft drink market is again a thing that is very small now compared to the overall figures in the industry. I would say here again canned soft drinks don't account for more than one per cent, or under two per cent of the industry production at the moment in Canada. There is a very limited market for cans, Mr. Walls. In certain seaports and that kind of thing -- there is a certain amount sold on ships, but taking the soft drink market, cans don't occupy a significant part at all.

COMMISSIONER WALLS: Well, certain chain stores on the Pacific coast have quite a lot of canned soft drinks imported from the U.S. offered. I would say more are being offered than bottled soft drinks at the present time. I wondered if this was so because they U.S. can take advantage of lower sugar costs.

MR. EMERSON: I think one of the main reasons are the marketing policies of the various chain stores. For instance, Safeways policy largely differs from Loblaws and Dominion.

MR. WOOLLEY: There is another factor that goes into that, sir. That is with the steel company. They operate with tremendous pressure on this canned beverage deal even to the point of subsidizing some of the advertising. In other words, it has made a false position. The promotion campaign is heavier than the actual sales.

THE CHAIRMAN: Well, I would think that you have taken care of all of our questions, I would say, most satisfactorily. Mr. Floody and gentlemen, this has been very helpful to us indeed. Thank you for your submission and appearing today and telling us about this problem. I can assure you we will continue to consider it.

MR. LATIMER: We are very grateful for your consideration.

THE CHAIRMAN: Mr. Secretary, we will stand over for ten minutes.

---A short recess.

THE CHAIRMAN: Mr. Secretary, I think we can commence.

THE SECRETARY: Mr. Chairman and Commissioners. The second brief this morning is being presented on behalf of ten general insurance companies by the Hon. Roland Michener, P.C., Q.C.

These insurance companies are the Canadian General Insurance Company, the Canadian Indemnity Company, the Canadian Mercantile Insurance Company, the Canadian National Insurance Company, the Casualty Company of Canada, the Commerce General Insurance Company, the Dominion of Canada General Insurance Company, the Provident Assurance Company, the Toronto General Insurance Company and the Traders General Insurance Company.

Mr. Michener is here to speak to the brief and he has with him a number of colleagues whom he will introduce to you, Mr. Chairman and the Commissioners. I would like to enter this into the record as Exhibit 285.

THE CHAIRMAN: Thank you, Mr. Secretary and good morning Mr. Michener and gentlemen. We are indeed flattered to have you before us today, Mr. Michener and we would be grateful, if before starting, you would introduce your associates to us.

We have read your submission with great interest and have our questions to put to you. There is no need to re-read it. We have already done that.

Thank you for appearing indeed and thank you for the submission.

SUBMISSION ON BEHALF OF:

CANADIAN GENERAL INSURANCE COMPANY
THE CANADIAN INDEMNITY COMPANY
THE CANADIAN MERCANTILE INSURANCE COMPANY
THE CANADIAN NATIONAL INSURANCE COMPANY
THE CASULATY COMPANY OF CANADA
THE COMMERCE GENERAL INSURANCE COMPANY
THE DOMINION OF CANADA GENERAL INSURANCE CO.
THE PROVIDENT ASSURANCE COMPANY
THE TORONTO GENERAL INSURANCE COMPANY
TRADERS GENERAL INSURANCE COMPANY

APPEARANCES:

Mr. Roland D. Michener, P.C., Q.C., counsel for the insurance companies.

Mr. W.G. Smith, Price Waterhouse and Co.

Mr. W.F. Spry, President of Canadian General Insurance Company, Toronto General and Traders General Insurance Companies.

Mr. L.L. Rooke, Managing Director of the Dominion of Canada General Insurance Company and the Casualty Company of Canada.

MR. MICHENER: Mr. Chairman and Members of the Royal Commission on Taxation. May I present those who are associated with me in this submission. On my right, Mr. William F. Spry, who is President and General Manager of three of the companies, the Canadian General Insurance Company, the first on the list and the last two on the list, Toronto General and Traders General Insurance Companies.

On my left Mr. Lisle L. Rooke, Managing Director of the Dominion of Canada General Insurance Company as well as the Casualty Company of Canada, two of the ten listed.

On my right again, Mr. William G. Smith, a chartered accountant and partner in the firm of Price Waterhouse and Company, practising in Toronto.

May I say, Mr. Chairman, that it is a pleasure to appear before this distinguished Commission and it is also interesting to be on the other side of the bench for a change.

We have set out in our brief everything that we wish to say and there is no need to read or repeat so I shall confine my remarks prior to submission to such questions and discussions as you might wish to introduce, to indicating the changes perhaps, if I can put it that way, the changes which have arisen since the brief was filed supplementary in point of time to the evidence which was submitted.

The brief makes three points. Basically it deals with the condition of the general insurance business in Canada and the general insurance business is fully explained in the preliminary three pages. My colleagues will be glad to answer any questions relative to this rather intricate field and as a witness to the side of the general insurance business we have relied very heavily on the Superintendent of Insurance, Mr. R.K. MacGregor; and we offer him as the best available evidence because he is the man whose duty it is to know all about the insurance business and how it is being conducted, particularly in the interest of the public but also in the course of these duties he knows what is going on.

We have relied heavily on his testimony as set out in his report for the year 1961.

I would like to make a brief reference to what he has said since then but before doing so the

second point we make is that this business of general insurance, like life insurance, is a peculiar and special business with characteristics of its own. It is on that basis that we venture to present a claim for tax consideration.

Our brief makes no general recommendation about the taxation system of Canada. We submit proposals in the context of the present corporation income tax and suggest that basically that as all funds of the company are committed to payment of its obligations to its policyholders until they are taken out as surplus and paid as dividends that taxation should be deferred until that point arrives.

To get to Mr. MacGregor's supplementary statement, the next annual report is out, that is the 1962 report. Mr. MacGregor is such a methodical man that the same tables appear on the same pages in 1962 as in 1961. References in the brief appear on three tables which affect these companies and can be read for 1962 as well as on the same page numbers; but in his report in 1962 he makes one observation that I think is worth citing, if I may. That is on page 34 of the report which is at the beginning of this volume for 1962.

He says "Since automobile insurance constitutes such a large proportion of the total business written in Canada, poor experience in that class naturally has a strong influence on total underwriting results. The relatively high claims ratio for automobile insurance in 1962 accounts in large

part for the much less favourable underwriting results as a whole in 1962. When poor experience in that class coincides with poor experience in other major classes, as in the years around 1957, (see pages 12 and 116 to 122), the premiums charged for some classes of business (including automobile and fire) are insufficient to cover more than a relatively favourable claims experience. Consequently, there are strong indications of the desirability of higher premium rates for these classes unless innovations and economies can be found to reduce expenses. Having regard for the keen competition provided by the relatively large number of insurers in the field, it seems likely that the solution to the problem of unprofitable results in so many cases will be found not only in some increases in premiums but also in reduced costs in marketing their policies".

We cite that to indicate that in effect the experience of the industry as recorded in the 1962 reports is the same as recorded in the brief, which is based on the 1961 report.

To bring the story up to 1963, may I refer, Mr. Chairman, to an address made by Mr. K.R. MacGregor, Superintendent of Insurance, at the annual dinner of the Toronto Insurance Conference. This address is published in full by the Canadian Underwriter. I have secured an off-print, two copies, which I should like to file one of these. I am sorry I have not six. I will file one of them and cite one or two remarks of Mr. MacGregor made in November of this year just to

indicate that the adverse trend for the industry, which is not the entire basis of our submission, but the adverse trend is still with the industry and seriously.

Mr. MacGregor said:

"It will be recalled that in the period 1948 to 1954, inclusive, the underwriting gains were reasonably satisfactory, being 5 per cent of earned premiums in 1948, eight per cent in 1949 and then five per cent in each of the five years 1950 to 1954".

THE CHAIRMAN: You said eight per cent in 1959?

MR. MICHENER: Eight per cent in 1949. I am sorry, Mr. Chairman, if I said 1959. It was 1949; and five per cent in each of the five years from 1950 to 1954. It was a relatively stable period of earnings. Then he goes on:

"During the ensuing eight years, however, the results were quite unsatisfactory, the series beginning with two per cent in 1955 then minus five per cent, minus 11 per cent, nil, three per cent, five per cent, five per cent and, finally, one per cent in 1962.

Taking the last eight years

together, the gains have little more than balanced the losses. After 1963 is included, the aggregate results since 1954 will definitely be in the red. Further, these results include the personal accident and sickness business of life insurance companies and if that business were excluded, the results would be somewhat less favourable still.

Clearly, the results for 1963, as respects profits are discouraging. The claims ratio of 66.0 per cent for the first half of the year is about 5 points higher than for the whole year 1962" --

that is the ratio of claims to premiums.

THE CHAIRMAN: Sixty-six per cent claims?

MR. MICHENER: Sixty-six per cent for the first half of the year 1963 which is about 5 points higher than for the whole year of 1962.

"Underwriting gain has likewise deterioriated by about five points, dropping from 9/10ths of one per cent in 1962 to a minus four per cent in 1963."

That is as far as the records go, to June.

That indicates the trend in the general insurance business.

I would just like to refer to a couple of more remarks before sitting down in which he talks about the companies which are represented here, that is the Canadian Incorporated and Canadian owned and controlled. There are twenty-one of these companies in Canada, that is joint stock companies in the general insurance field. Ten of them are represented here. We are in the same category as all Canadian incorporated companies but we are, as a group, actually Canadian controlled and owned companies. That is, the general class of Canadian incorporated which would include many foreign interests.

Mr. MacGregor says -- incidentally the title of his speech was "The Law and the Profits". He did not find out or suggest how the companies could make a profit. He painted a rather realistic picture. He says:

> "In some cases, smaller companies have developed a successful operation but, all things considered, I cannot help feeling that the future road of the small company is apt to anything but smooth.
>
> This is unfortunate in the light of the rather special situation that exists in Canada today and has existed for many

years. I refer to the fact that the fire and casualty industry in Canada is to a very large extent in the hands of British and foreign companies. Setting aside the personal accident and sickness business of life insurance companies Canadian-owned fire and casualty companies transact only 15 per cent of the total fire and casualty business in Canada.

Canadians are understandably reluctant to contemplate the possible disappearance of Canadian-owned companies except for a very few that are able to adapt themselves in some fashion so as to survive. It would be unfortunate and undesirable, I suggest, for Canada or any modern country to be completely dependent upon outside interests for its fire and casualty facilities."

I believe, Mr. Chairman, that brings the record up to date with these additions. I shall be glad to endeavour to deal with any points which the Commission might wish to raise.

THE CHAIRMAN: Thank you indeed, Mr. Michener, for your remarks.

I think I would like to proceed in the following manner, perhaps to understand better the submission to us and put a few questions in regard to the profit position of the industry with which you dealt and then get to your submission and the type of adjustments for which you ask in your submission.

The twenty-one joint stock companies which you mentioned and of which ten are represented here, these, I think you said, were Canadian companies. I was not clear whether they are Canadian-controlled companies.

MR. MICHENER: Yes, these are Canadian incorporated and Canadian-controlled.

THE CHAIRMAN: Which represent in volume about 15 per cent of the total business.

MR. MICHENER: Yes. It has been less than that. We have an exhibit, Exhibit B at the end of the brief, page 22. We have compared the business of the Canadian-controlled and that is these twenty-one companies. First we have set out the British and foreign branches and the business and then we have set out the Canadian controlled Joint Stock in general insurance companies, which number twenty-one, and then the other insurance companies incorporate in Canada which number in all about 108. So there are twenty-one Canadian controlled out of 108 Canadian companies. In addition to that there are branches of other companies which bring the total in the field up to 357 businesses.

THE CHAIRMAN: So when you said 15 per cent

of the total business, it should have been something less than 9 per cent, I take it, from what you say.

MR. MICHENER: Mr. MacGregor quoted 15 in the extract which I read but it varies. It is 8 per cent of the net premiums written in Canada that these companies shared. Also that table is set out to show both that proportion and the income tax paid.

THE CHAIRMAN: Now, why should these ten companies be appearing before us as a group rather than the entire industry? I presume the answer to that lies in the fact that they are Canadian companies, Canadian controlled. But if that is so, why is it not 21 companies rather than 10? Is there a reason for that?

MR. MICHENER: Well, perhaps Mr. Spry could say why it is these ten rather than 21.

MR. SPRY: Mr. Chairman, there is no reason why, I suppose, we could not have contacted these other companies and asked them to join with us but we felt that if we were to begin to study this submission in time, we could do it more effectively if we reduced the number of companies, with the larger operators of the purely domestic companies. They are spread around in different parts of Canada. As it was, we had difficulty in getting representations from St. Hyacinthe and Montreal and Winnipeg.

There is no specific reason but we felt that we would merely get somebody from western Canada, Quebec province and a couple from Ontario.

THE CHAIRMAN: Thank you, Mr. Spry. I presume any organization would include all of the 108 or whatever people in general insurance. There must be an association of general insurance underwriters.

MR. SPRY: There are two main associations, one is Canadian Underwriters Association and the other is the Independent Conference Group. There are a large number of insurers which we may refer to as independents. They are not members of either Canadian Underwriters Association or the Independent Insurance Companies.

THE CHAIRMAN: What companies would qualify for the Independent Insurance Conference? I am thinking what the word "Independent" means.

MR. SPRY: The Independent Conference Group are largely companies that are known as non-tariff or non-board companies as distinct from the various companies who are members of the Canadian Underwriters Association.

COMMISSIONER PERRY: Mr. Ham, Leslie Ham?

MR. SPRY: Canadian Underwriters Association.

COMMISSIONER PERRY: That is why I referred to him.

COMMISSIONER GRANT: The Canadian Underwriters Association has provincial offices and provincial officers, has it not?

MR. SPRY: That is correct.

COMMISSIONER GRANT: Those who are members of that, they take their premium rates from the Board.

MR. SPRY: That is correct.

COMMISSIONER GRANT: They are commonly referred

to as tariff companies?

MR. SPRY: That is right.

COMMISSIONER GRANT: And those outside are the non-tariff companies?

MR. SPRY: That is correct.

COMMISSIONER GRANT: The companies that you represent here today are all tariff companies?

MR. MICHENER: No, Mr. Spry is not.

MR. SPRY: It is rather involved. I will do my best.

THE CHAIRMAN: Do we want to go into this?

COMMISSIONER PERRY: They all sell insurance.

COMMISSIONER GRANT: My main reason for asking this is that later on I was going to ask for some information as to the competition between the tariff companies and the non-tariff companies in so far as the rates are concerned.

MR. SPRY: Well now, perhaps for the general information of the Commission, it is possible in the Canadian Underwriters Association to be a regional or territorial member of that body. You don't, of necessity, have to be a member in each of the provincial jurisdictions or branches. For example, two of our companies are members in some of the Atlantic provinces. Down there we are recognized or known as just tariff companies.

COMMISSIONER GRANT: Yes.

MR. SPRY: The same condition applies to Mr. Rooke's companies, the Dominion of Canada General Company and the Casualty of Canada. I believe Mr. Rooke that in

western Canada you are a member of one or two of the jurisdictions of the group.

MR. ROOKE: That is the only territory. We are not members in the Maritimes.

MR. SPRY: So we can't give you a specific answer, yes or no, as to whether these companies are tariff or non-tariff.

COMMISSIONER GRANT: Is it a fact that a Canadian company may be tariff in one province and non-tariff in another.

MR. SPRY: That is correct.

COMMISSIONER WALLS: I have a question about Table B that we were discussing a minute ago.

THE CHAIRMAN: We were only discussing the number of companies and not the figures in Table B. There is a lot more to Table B to look at in a moment. You make the point that your industry is pretty unprofitable by figures given by Mr. MacGregor. He indicates it is unprofitable because you don't charge enough for your product. By saying you don't charge enough, I suppose you say competition is too keen and you are unable to do so. Would it be right to suggest that is perhaps because of the large number of non resident companies in this business. Sixty per cent of the premiums are written by branches of non-resident companies, I think. Does that in any way depress the earnings of the business.

MR. SPRY: It does to the extent that the prices are reduced in the free competitive market.

THE CHAIRMAN: Don't they want to make a

profit just as much as the rest of you?

MR. SPRY: One would think so.

THE CHAIRMAN: I raise this point because it is not a sudden condition. It has been going on for quite some time. When this happens over a period of time certain forces of economics enter into the condition and either people go out of business or the merge and the situation corrects itself. This doesn't seem to be happening here. Is there anything you care to add?

MR. MICHENER: I will answer this, Mr. Chairman. It seems to me that the Canadian companies are going out of business as Mr. MacGregor pointed out, last year there were casualties of nine of the Canadian incorporated companies, taken over by others. In our consideration, and we haven't got concrete evidence, but it supports the view that the foreign companies operated by branches are prepared to go without profit for longer, as is suggested in the brief. The attractiveness of the Canadian market to European companies that want a safe haven for selling their insurance business in the event they get into difficulties that Europeans have been faced with before. To establish this we suggest that they may be prepared to undersell and to forego profits.

THE CHAIRMAN: I know if one insures an automobile in large urban centres in the United States it generally costs a great deal more than it does in Canada yet it is said that the Canadian automobile insurance business is most unprofitable. I heard that said again this morning. I would think that in time

rates would have come up to take care of the unprofitable situation. That doesn't seem to occur and I can't understand why not.

MR. ROOKE: Mr. Chairman, going back to our first question, approximately 60 per cent of the business is written by branches of the British and foreign companies- they are the dominant factor by reason of the volume, and one of the views that I hold is the fact that as far as the Canadian controlled companies are concerned or Canadian incorporated companies, is the reason that they have the scope of Canada mainly. In so far as the domestic companies, their operations in Canada are only a small part in most cases of their world wide operations. They are operating branches, as we have indicated. While their anxiety for a profit is there it is not, in my judgment, to the same extent as a company such as those who are parties to the brief where their scope is restricted to Canada. I think that is one of the facts in regard to their philosophy as compared to that of a company operating solely in Canada. Competitively it is very difficult for a company operating in Canada to charge higher premiums or to restrict the cover on the contract to less than what is available on the market.

THE CHAIRMAN: Thank you.

COMMISSIONER BEAUVAIS: I have a question on Exhibit B. For the Canadian controlled joint stock insurance companies you have indicated they have 8.78 per cent of the premiums written in Canada but the profit is 15 per cent so it means to me that you are

taking a better percentage of profit, isn't that so?

MR. MICHENER: That is not the whole case because that 15 per cent is a percentage of profits and of investment income.

COMMISSIONER BEAUVAIS: The investment income is included.

MR. MICHENER: To the total, so there is a different factor. The Canadian companies maintain investments in Canada sufficient to establish the reserves they require.

THE CHAIRMAN: I wasn't going to come to the figures for a minute or two, Mr. Beauvais, but you are quite right, the difference on that schedule is most conspicuous. When we come to the figures we obviously have to inquire into it.

COMMISSIONER PERRY: There is one question I have which is really a tax question but bears on this subject of foreign competition and it may well go beyond the extent of your research. I wondered whether you have any evidence of the possibility that the way in which branches of foreign companies are taxed either in Canada or in their own country has a bearing on your competitive position in Canada? If you have done this you have done quite a sweeping study of taxation both here and abroad. I wondered whether you had any comment to offer on that.

MR. MICHENER: We haven't endeavoured....

COMMISSIONER PERRY: I don't think there is anything in the brief on it.

MR. MICHENER: We have't endeavoured to follow

the tax position of the foreign companies beyond the 15 per cent withholding tax, beyond what the Canadian authorities tax.

THE CHAIRMAN: Perhaps we ought to move right to Schedule B because it is in line with the last two questions and I think we have come to it. The point there, it seems to me is this schedule would be easier to understand .. the underwriting profit on investment income were it put in two columns rather than one column because the tax on investment income for the British and foreign branches, as pointed out, is a different tax than it is on Canadian profits. Again that, of course, is influenced or affected by what Mr. Perry asked, what happens to the investment income when it gets into the country of the parent. Is it again taxed?

MR. MICHENER: Yes.

THE CHAIRMAN: In fact are these things as much out of balance as you indicate because if that investment income of the British and foreign branches were taxed they may not be out of balance.

MR. MICHENER: We are unable to supply those figures. We assume they are subject to other taxes, but to what degree, I think none of us are able to give you much assistance at the moment. We deliberately avoided trying to make too much comparison with these other companies. They only come in incidentally. In the brief we have tried to make our own case on its own merits, that is far as income tax, as far as reserves and income tax are concerned. We haven't concerned ourselves with making too invidious comparisons

with competitors abroad, life insurance companies. We plead our own case.

COMMISSIONER PERRY: I concede that my question was highly sophisticated, involving an answer I have been seeking for some years. I am not surprised you don't have it.

MR. MICHENER: Unless Mr. Smith could help us with it.

MR. SMITH: There is one element of the taxation where the foreign branch has an advantage over the Canadian incorporated company.

THE CHAIRMAN: Yes.

MR. SMITH: In that underwriting losses are the only income of the Canadian operations.

THE CHAIRMAN: I am sorry?

MR. SMITH: The investment income is income of the British parent and therefore your underwriting loss as such can be set off against future underwriting profits as we have quoted in the brief.

THE CHAIRMAN: Where is that stated in the brief?

MR. SMITH: At the bottom of page 12.

THE CHAIRMAN: "Part of the difference..."

MR. SMITH: Yes.

THE CHAIRMAN: "Part of the difference in income tax payable in Canada arises because the investment earnings from branches in Canada of British and foreign companies are not subject to Canadian income tax except the 15 per cent withholding tax. The result is that the branches in Canada of such British and

foreign companies pay income tax on their net underwriting results on a rolling five year basis whereas underwriting losses of Canadian controlled joint stock general insurance companies incorporated in Canada can only be recovered on this five year basis to the extent that such losses exceed taxable investment earnings during the same period". I follow your point that the advantage of the average can only be taken into Canada to the excess over investment income whereas in regard to foreign companies the full advantage can be taken without deducting investment income. That is so.

MR. SMITH: Yes, that is so.

COMMISSIONER PERRY: Would the witness mind giving the reference for the statement? Does it appear in a regulation or is it simply known to be the practice?

MR. SMITH: I think it is basic in the method of taxation of the two groups of insurance companies.

THE CHAIRMAN: The investment income in British and foreign companies is not brought into earnings but is taxed separately.

MR. SMITH: Part may be. Part is not. It depends on the circumstances of each group. Taxation of foreign insurance companies is largely controlled by legislation.

THE CHAIRMAN: It would seem to me the best way to discuss what you have put before us is to go right to the point set out in your conclusions where you said that the present practice of taxing these people is not in accordance with generally accepted

accounting and economic principles.

Just take accounting principles for the moment and tell me whether, if you can, the determination of taxable income as now determined in the case of the Canadian company -- I am not speaking about foreign companies -- varies from the generally accepted accounting principles.

MR. SMITH: Mr. Chairman, it is a rather difficult question to answer and this thing almost comes out of taxation and into accounting principles and the presentation of insurance companies balance sheets generally.

THE CHAIRMAN: I think we must argue there because what you are saying is that you wish to vary the measurement of income which in fact is in accordance with accounting principles. If you wish to move away from it -- you wish to move away from accounting principles, from what you are saying.

MR. SMITH: Well, here is an insurance company balance sheet. You have a surplus which under accounting principles is your surplus but unlike any other ordinary company that surplus is not a shareable surplus. It is subject to a number of restrictions and deductions under the insurance regulations. It is these compulsory deductions from surplus which we have made the subject of this brief and they are moving into line with normal accounting thinking. If a reserve is necessary or compulsory, it should be left out for tax purposes.

THE CHAIRMAN: All right, but then are you not saying that the method normally accepted to present

financial statements of these companies is not in accordance with generally accepted accounting principles, apart altogether from taxes because I think you are taxed in accordance with the normal method of presenting financial statements, are you not?

MR. SMITH: In respect to one specific item, for example, that 15 per cent provision for assets over liabilities, it is not set out in the Act to be a provision.

THE CHAIRMAN: It is not normally shown on the financial statement.

MR. SMITH: No, because it is not set out in the Act to be a provision. It is required or it is an requirement in the Act to be held in surplus.

THE CHAIRMAN: Granted, but an accountant does not require that to be treated as a surplus. It is merely that your assets must exceed your liabilities by 15 per cent in order to stay in business but nobody anywhere says that is required to be treated as a reserve.

MR. SMITH: No.

THE CHAIRMAN: An accountant does not so treat it.

MR. SMITH: No.

THE CHAIRMAN: Therefore what I am saying to you is would you please tell us to what extent and how what you recommend would bring you into accord with generally accepted accounting principles for the insurance business.

MR. SMITH: Well, I think it would probably

mean if these reserves were allowed for tax purposes. I am speaking now of -- not on behalf of the accounting profession itself -- this is a personal opinion, I think you would probably have to set -- the profession would have to set out the principles involved, lay down standards for -- uniform standards for the profession. It would probably result in setting up this provision or note it on the balance sheet somewhere to explain that this is what surplus was reserved under the regulations and, of course, the proper amount of income tax deferred would have to be set out.

THE CHAIRMAN: I think all you were saying is that if the tax law provided for it, accountants might accommodate themselves by the tax law.

MR. SMITH: Yes.

THE CHAIRMAN: Well then, what would an accountant do if there were no taxes at all? What would be the position in respect to accounting principles? That is the principle they are following now, is it not?

MR. SMITH: That is the problem. You have two conflicting acts at the present time in presenting a statement.

THE CHAIRMAN: The percentage reserves that you ask for are not shown on the financial statement.

MR. SMITH: That is right.

THE CHAIRMAN: If there were no taxes and no requirement to establish reserves, I suggest to you that probably would not be shown on the financial statement. Do you agree?

MR. SMITH: That is correct, if there was

no regulation.

THE CHAIRMAN: What you are saying is that the reserves be set under the Act, which is a departure from current accounting principles as now applied in the industry.

MR. SMITH: That is correct, sir.

THE CHAIRMAN: It does not bring it into line with accounting principles. It is to create a departure from accounting principles in the industry.

MR. SMITH: Yes, sir.

THE CHAIRMAN: What you are saying is that such a departure would conform in your view closely to general accounting principles of all kinds but not in respect to this industry.

MR. SMITH: Yes, that is the point. This is a comparison with general accounting principles as distinct from the insurance industry. It does not ---

THE CHAIRMAN: So then you are saying the accounting principles as employed in this industry, do not conform to general accounting principles throughout ---

MR. SMITH: That is right.

THE CHAIRMAN: By suggesting this industry is perhaps deficient in its accounting principles.

MR. SMITH: No, well not deficient itself. I would say it is a conflict of two Acts affecting one set of circumstances.

COMMISSIONER BEAUVAIS: On this point, Mr. Chairman, is that similar to the depreciation that you take for income tax purposes and yet you are not obliged to show that in your books.

MR. SMITH: It is similar because in such cases the Department would find that is commonly done by the auditor.

THE CHAIRMAN: Right now, Mr. Beauvais, the tax returns of these companies filed shows an income which varies a little bit from that reported by the financial statements to the extent of disallowed assets. That is about all. Am I not right?

MR. SMITH: That is correct.

THE CHAIRMAN: Disallowed assets are crossed off the balance sheet and adjusted through the surplus account, whereas for tax purposes they are brought back in.

COMMISSIONER BEAUVAIS: Well, can you give me an example of these assets?

THE CHAIRMAN: Furniture and fixtures.

It is a very small adjustment and one not usually worth considering.

MR. MICHENER: It becomes important, Mr. Chairman, if a company invests in modern business equipment. It may become important in a period. There may be very substantial expenditures for I.B.M. systems or business machines. This is one of the things that the Superintendent mentions about the industry.

If it is ever to make a profit, it must cut down its expenses. He suggests the larger companies have an advantage because they are using more machinery to save expenses. In that case it might be a factor. We have not over-emphasized it.

THE CHAIRMAN: Yes, it could be. Of course,

an awful lot of that equipment would be rented rather than purchased.

MR. MICHENER: Yes. In any event it would probably be non-recurring. Yet a company rehabilitating itself or moving to a new office might spend very substantial sums in one year.

THE CHAIRMAN: And get very heavy charges against income in that year.

MR. MICHENER: Yes.

COMMISSIONER GRANT: Referring to Exhibit B again, it seems to me that you really find yourselves the victims in the insurance business being a joint stock company and being in competition with companies whose figures are on the top line and companies whose figures are on the bottom line because these two enjoy tax privileges which you, as joint stock companies, do not.

MR. MICHENER: We say that we are taxed on a different basis. Yes, that is substantially our position.

COMMISSIONER GRANT: Because you are paying 37 per cent off your underwriting profit of investment income in taxes whereas your competitors are paying about 20 per cent.

MR. MICHENER: Yes, that is the net result. That is the way it works out over the years.

COMMISSIONER GRANT: What you are looking for now is for a change in the Act which will permit you to set up some taxes from reserves.

MR. MICHENER: That is what we are asking for.

COMMISSIONER GRANT: With that you feel you

would be in a more competitive position with your other competitors in the insurance business.

MR. MICHENER: Yes.

COMMISSIONER GRANT: And if these taxes from reserves were permitted to be set up, the income derived from them, I presume most of it will be in the form of investments and from the nature of the business would be subject to taxes.

MR. MICHENER: Yes, it would. We feel it would improve, as stated in the brief, the competitive position of the Canadian companies to free its own funds by deferring these tax payments on these reserves, to generate funds which could be used for development and expansion.

THE CHAIRMAN: Mr. Michener, you can only say that these companies have an advantage to the extent that that investment income of non-residents bears to less taxes than does the investment income on residents but that is not the whole case because when you are considering investment income of non-residents, I think you must consider the taxes in their own countries.

MR. MICHENER: Yes, also the balance of the arrangement under which they pay taxes in Canada. It is not the whole story. What we say is that the experience as set out in Exhibit B indicates that in fact the Canadian-controlled companies have been paying a relatively greater share of income tax, a substantially greater share in relation to the amount of their share of the volume of business.

THE CHAIRMAN: I suggest to you, Mr. Michener,

that is about as significant as saying I pay more income tax than does somebody living in the U.K. who has invested income in Canada.

MR. MICHENER: If you are going to take into account the taxes that are paid there, yes, but after all they are doing business here on competitive terms. That is, we are not able to say what advantages or disadvantages they have in their own tax jurisdictions.

THE CHAIRMAN: If we look at the underwriting profits separately, we find they are about the same as yours.

MR. MICHENER: Yes.

COMMISSIONER BEAUVAIS: Could we havethose underwriting profits separated.

MR. MICHENER: The latest information about underwriting profits is contained in the report of the Superintendent for 1962. Full details are given in the report but he summarizes it at Table A on page 10 of the Superintendent's report. That sets out the net premiums, Reinsurance for Canadian companies but only registered or licensed British and foreign companies.

This relates to the percentage of business not to underwriting gain or profit. Perhaps we have a table on this sheet for underwriting gain or profit.

THE CHAIRMAN: You would not have it classified in that way, would you?

MR. MICHENER: The Superintendent has classified it in this way.

THE CHAIRMAN: He has?

MR. MICHENER: Yes, he has because of his

interest in the problem. He has written fully about it last year in his report from the way he quoted that. I will see if I can find that.

THE CHAIRMAN: Thank you.

COMMISSIONER GRANT: On page 4 you make a remark that foreign companies doing business in Canada are able to retain larger risks without recourse to so much capitalized reinsurance. At present a substantial part of such reinsurance is placed with reinsurers based outside of Canada. What I would like to know is how much the reinsurance of risk bears on the premium cost.

MR. SPRY: Well, gentlemen, the larger base capital and the larger the spread, the larger the net retention of the carrier. A company with a base capital of $150 million can take for its own account on reinsuring a much larger risk than a small domestic company, such as anyone of our group, you see.

So, if we are asked to compete with one of the other companies and write a risk for $1 million, it is conceivable that some of the large world wide corporations might wish to retain $1 million or $2 million of that risk net; whereas because of our greatly reduced base capital we may decide to retain only $25,000.00 so we have to resort to reinsurance.

We go to the London market and under treaties, they take the excess of that primary retention of ours on an agreed basis.

The agreed basis is usually geared to the loss ratio. If it shows a small margin of profit to them, they are satisfied at the rate they have struck.

If it is producing too much profit, well then they are going to reduce the price so it will go to some other Reinsurance market.

On the other hand, if it is unprofitable to them, they want us to increase the price we pay them.

For domestic insitutions to compete with large world wide carriers, we could not do it if it was not for the availability of these large professional Reinsurance markets which exist in New York and London or in continental Europe. That is what we mean by that.

COMMISSIONER GRANT: Well then, Mr. Spry, if the company is large enough and can retain the business within itself, without having to farm it out, so to speak, then, in the event that the loss ratio is favourable its profit position is going to be that much better and that in turn would have a direct bearing on the rate at which you would be able to quote.

MR. SPRY: That is right.

COMMISSIONER GRANT: Your British based company which, say, has been in operation for centuries, and does business in all parts of the world, probably has got a broad base and can compete with you in Canada on a premium basis, which makes it difficult for you to compete.

MR. SPRY: That is correct. On some risks, where we are asked to quote, depending on the amount of the risk -- it may be $1 million or $2 million, depending on the hazardous nature of the risk, before we can quote frequently we have to contact the London market by cable or by telephone and ascertain what price they

want for the excess over our retention.

Depending on what they are going to charge, certainly will depend on what we are going to charge and frequently we find that we would make a quotation and we were anywhere from 15 to 25 per cent higher than some of the rates quoted by some of the larger world wide insurers.

COMMISSIONER GRANT: I think British companies have become quite aggressive in recent years in Canada. They have bought up Canadian companies.

MR. SPRY: And the Americans too.

COMMISSIONER GRANT: They are now operating. The insurance business has undergone a change.

MR. SPRY: And the Germans.

COMMISSIONER GRANT: I beg your pardon?

MR. SPRY: And the Germans and the Swiss and the Dutch. We have a lot of Canadian incorporated companies in Canada owned by not only American interests but by British and other European interests. I think, and I know that Mr. MacGregor freely admits, I think Canada is the most over capitalized country in the world so far as the general insurance business is concerned.

COMMISSIONER GRANT: The business of the Canadian General Insurance Company of which you, Mr. Spry, are the head, you show under underwriting profit in 1961 a markup almost the same as 1960. Are you in the life insurance?

MR. SPRY: No, general insurance agency.

COMMISSIONER BEAUVAIS: I have a question here on page 19 under Item entitled Specific Recommendations.

You say "That the earnings or profits of general insurance companies incorporated in Canada should be taxable only to the extent that they are finally and definitely available to the shareholders, that is, when such profits are taken into corporate surplus accounts". You say "We are familiar with the tax philosphy on which a similar practice is permitted with respect to life insurance companies". Could you give us an explanation of this philosphy?

MR. ROOKE: I will endeavour to. This apparent philosophy, in my judgment, that profits occurring on life insurance are not taxed until they are brought into the shareholders account because that business is engaged in a thrift business or business which is incurred with thrift or is cut on fabric of the country. I believe that is the thinking behind the exclusion of that profit. My company happens to be engaged also in life insurance business as well as in the general insurance business, so we are in a position profits accruing from the life insurance portion are not taxable until they are brought into the shareholders' accounts whereas profits from the general insurance business are taxable when earned.

THE CHAIRMAN: The difference I think being, Mr. Rooke, in the case of life insurance companies there are substantial reserves established and required to be established to protect policy holders and it is only to the extent that these reserve requirements are satisfied that the general surplus account of life insurance companies become available. That is what

you are saying really in your submission, that some kind of larger reserve should be permitted for fire insurance companies. Right now actually, I think you are only taxed on what is credited to your corporate insurance account in fire insurance. You are suggesting you credit your surplus account with too much now and you are suggesting certain reserves should be made against that. I think the practice we follow now with regard to tax is what you say. Am I not right, Mr. Smith?

MR. SMITH: That is right, the corporate surplus -- really the intent there was available as a corporate surplus for dividends.

THE CHAIRMAN: You are saying corporate surplus accounts as now employed in fire insurance companies is what it should be.

MR. SMITH: That is right.

THE CHAIRMAN: It is the corporate surplus.

MR. SMITH: It shows the surplus.

THE CHAIRMAN: It contains what you suggest should be reserve.

MR. MICHENER: If at the present time we accept it as reserves there would be no tax. That wouldn't be recognized. What is available goes into surplus.

THE CHAIRMAN: That is correct. Now, Mr. Michener, I think what we have got to look at is if there was no tax what would the reserves be? Why did this industry not always establish reserves somewhat like the life insurance industry has irrespective of

tax, establish reserves if it needs reserves. If this industry needs reserves it should have reserves whether it is taxed or isn't taxed.

MR. MICHENER: That is the point we are making. Perhaps we haven't made it on the correct basis by saying -- according to good accounting business it should be there but good economics indicates that the application is there throughout the business course of a general insurance company. Its assets are committed to liabilities which are unknown and unforeseeable. I think it has been well illustrated in the history of the Canadian companies. You get the fire of 1877 in St. John's which put most of the Canadian companies out of business, and you had three instances starting with the St. John's fire.

THE CHAIRMAN: The point you don't make is why these reserves were not made irrespective of taxes. The Tax Act does not prohibit reserves. It doesn't do anything to stop reserves. Income tax only started in 1917 and it only became large in respect of these companies in relatively recent history. Why before this, why did this industry not set up a practice of establishing reserves, why wait until taxes are high. You are only motivated by taxation. If the motive was accounting you would have done this long ago.

MR. MICHENER: That is, perhaps, justifiable criticism. As long as the funds are in surplus they are available, they are in reserve or surplus, they are left for the contingencies of the insurance business. It is the option of the shareholders what they draw out

in profits. That is the only difference that arises. Until the surplus is actually distributed it is in a different position that in most businesses. That is why we say it is not in accordance with good economics to regard any insurance revenue as income until they have been distributed, and that is the position the fire insurance companies have taken. We suggest that what applies in that industry, in that kind of insurance applies with equal force in this kind of insurance. The only difference is one is insurance of life and the other is insurance of a man's assets, both equally indispensible in the society in which we live. If you haven't life your assets don't have much consideration except for your heirs. The public aspect of the two kinds of insurance is comparable. I suggest that the reserve position of the two should be comparable because the liability of earnings is basically the same in both types of insurance. In that way, in that respect insurance is different and distinguishable from other kinds of business. It is on that basis, the peculiarity of the business that we suggest not only is it economical to set up reserves but it is also good tax policy to permit reserves to be established before taxation and the tax be deferred until the money is actually distributed.

THE CHAIRMAN: Mr. Michener, I would have thought the reserves would have to be justified as an objective measure. It would have to be said that these reserves are necessarily reserves in order to properly measure income of the companies, not to hold

back taxes. That is turning the whole thing around. I think in the life insurance business these reserves have always been fair reserves. They need to be there. One recognizes the need to be there. I have been rather surprised that general insurance, casualty insurance has not provided reserves, not for tax purposes, but as a proper measure of the income in order to protect their own company. To bring this forward as a tax measure seems a little scurrilous. I would have thought that it should have been brought forward apart from this, that we need reserves in order to come down to the proper income, in order to protect our business -- there are all kinds of reasons other than taxation. Taxation should be levied on a proper and appropriate measurement of income, and the best measurement of income that can be maintained. The best measurement of income can be obtained is generally what is established by accountants on financial statements. You are saying that isn't the best measurement of income. Perhaps that is so. If that is so you have a case to make, and it isn't an easy one.

MR. MICHENER: I can only repeat what I said before, income and surplus is actually reserve in the case of insurance companies. The real test of the conduct of the industry is how much they pay out in dividends. It is a reserve just as much as if it had been called a reserve.

THE CHAIRMAN: Are you saying that about all industry or just fire insurance?

MR. MICHENER: I am saying that about general

insurance only. The amount that is paid out, of course, is reflected to some extent by Section 64 and also Sections 103, 4 and 5 of the Insurance Act containing the conditions in which insurance companies may pay dividends. They may not be able to pay dividends if they have, let us take, even if they have a surplus and what has been put into reserves, they may not use that for dividends if they didn't have an average profit over three years, and other considerations -- if they used reserve capital and so on. They are not treated as other industries are in the way they are regulated. They are more severely regulated.

COMMISSIONER BEAUVAIS: When you say this, available for dividends but not necessarily distributed.

MR. MICHENER: I am sorry?

COMMISSIONER BEAUVAIS: Distributed.

MR. MICHENER: I say distributed -- only theprofits of the general insurance company are distributed. They are all subject to the policy holders claims.

COMMISSIONER BEAUVAIS: I mean in your brief it says they are finally and definitely available to the shareholders. There is a difference.

MR. MICHENER: What we should say is distributed, following the discussion we have had with the Chairman.

COMMISSIONER PERRY: The Act, [illegible] Section 7, refers to amounts credited on shareholders account or otherwise appropriated for or on behalf of shareholders.

COMMISSIONER BEAUVAIS: That is my point.

MR. MICHENER: That is the point. We were thinking of the comparable situation. I was saying Mr. Chairman, about underwriting gains in the Canadian controlled companies. I find that the Superintendent, he has underwriting gains, but he hasn't segregated the 21 companies, nor have we. We could do that if your Honours wish it done.

THE CHAIRMAN: I don't think so. We could easily get it from the Blue Book ourselves.

MR. MICHENER: They are set up in the Blue Book. The only comparison of underwriting gains is that of Canadian companies as compared to all British companies and all foreign companies. That is in the Superintendent's report for 1961 at page 30. Then he also makes the comparison of underwriting gains for the first six months of this year in a speech he made at Toronto. That is such a short period I could scarcely tender that as representative. He shows general Canadian controlled companies. That is the document I presented to you, Mr. Chairman. If we can do more for you we will if it is desirable.

COMMISSIONER GRANT: I suppose Mr. MacGregor's report is just factual. He doesn't draw conclusions or make recommendations with respect to the Canadian controlled companies?

MR. MICHENER: He says frankly he doesn't know the answer. He hasn't said what we propose in our brief is the answer. He leaves it open to argument. That is one of the arguments that would help Canadian business anyway. Maybe it can help us.

He says the industry must take either the course of increasing the premiums for insurance or reducing the cost. That is axiomatic. He doesn't indicate how it could be done.

COMMISSIONER GRANT: I see foreign based companies competing in all fields of insurance. Are the British companies as active in the automobile insurance as you -- they don't place any restrictions on the coverage?

MR. MICHENER: No. Their division of business seems to be comparable to the Canadian corporations and Canadian controlled companies. They are in all the three major lines of general insurance.

THE CHAIRMAN: I have one question here. You make the point that there are legal requirements which act as a restraint on Canadian controlled companies acquiring other business. You say "See page 9". That comes up on page 16, paragraph 3 with reference to page 9.

MR. MICHENER: Yes. That is the reference to the portion of the Canadian and British Insurance Companies Act. There are two provisions that we suggest amount to a restraint. The first is in Section 63, subsection 7 which says: "The total book value of the investments of a company in common shares shall be limited to 15 per cent of the book value of the total assets of the company", so that an insurance company can make investments only to 15 per cent of the common shares. If we put all that 15 per cent of the common shares with one other insurance company it

isn't likely it would amount to control.

The other restraint is in Section 64, sub-section 1 which says: "Nothwithstanding anything in Subsection 1 of Section 63 a company other than a company registered to transact the business of life insurance may invest its funds in the fully paid shares of any other company transacting the business of insurance or of any corporation incorporated outside of Canada and transacting the business of insurance. No such investment shall be made if as a result thereof the total amount invested in such shares would exceed 50 per cent of the surplus of such company as shown in the most recent annual statement deposited in the Department". So that there are two limitations on insurance companies and proper limitations. I do not suggest there is anything improper about them. There are two limitations preventing acquiring control of another Canadian insurance company.

It is obvious that there are too many insurers in the business. That is clear from the present condition of the industry. There are 357 altogether, counting all classes, Canadian-incorporated, British and foreign and amalgamation or consolidation might be a very healthy development in the industry but that is restrained by Canadian companies extending the process to their own advantage.

THE CHAIRMAN: Is that not a very unfair restraint, in that if a Canadian company buys another company in its entirety, buys the assets and assumes the liabilities of the company, that restraint would not

apply because the shares of the other company, which is acquired, would not appear in its investment portfolio.

MR. MICHENER: If two companies were merged, it would be done.

THE CHAIRMAN: Buy the assets and assume the liabilities.

MR. MICHENER: Yes. That could be done. If shares of another company were held as an investment, this restraint operates very effectively.

THE CHAIRMAN: The restraint would operate if you were to buy 95 per cent of the shares of the company but you could not afford to buy the other 5 per cent; whereas if you got the whole 100 per cent, bought the assets and assumed the liabilities, the restraint would not apply.

MR. MICHENER: Yes.

THE CHAIRMAN: It would seem to me there should be a modification of that restraint. It is impeding your progress.

COMMISSIONER WALLS: Prior to the present legislation being passed in 1952, what had the experience been? Do you think there had been too heavy an investment in common stocks, which resu[illegible] in certain practices?

MR. MICHENER: I cannot say, Mr. Walls. I think it was rather the other way. It was permissive rather than restrictive. I am not sure the power to invest existed at all before that. I cannot answer that.

COMMISSIONER GRANT: I rather think it relates back to the thirties. Some of the life insurance companies were suffering from too heavy

investment incomes and the Canadian-British Insurance Companies Act was amended around that time, I think.

MR. MICHENER: Yes. It was during that particular period, apparently in the twenties or thirties. They had over-invested. I am not sure that applies to the general insurance companies. I will find that out and give you that information.

THE CHAIRMAN: Mr. Michener, so that we will be perfectly clear as to what you are putting before us, might it be useful to refer now to page 23, which is your proposal for profit income gain for the Canadian General Insurance Company.

MR. MICHENER: Yes.

THE CHAIRMAN: Referring to the differences that result in say 1961, what you propose as against the actual. The first difference is given as unlicensed reinsurance and that comes in on both sides. As you look at the exhibit I wonder why there is a difference between the two columns. On page 23 the last two columns on the righthand side which are headed 1961.

MR. SMITH: Yes.

THE CHAIRMAN: And about the fourth item down is "unlicensed reinsurance" and under the column in 1961 under the heading proposed there is a figure 313,187 and then under the "Actual" there is nil.

Then, if you go down to the lower part of the page where it has "unlicensed reinsurance" there is nothing in "actual" and under "proposed" there is 351,486.

Unlicensed reinsurance is again a similar

provision to the statutory 15 per cent.

MR. SMITH: It is a regulation. It is not a compulsory reserve. It doesn't apply to all insurance companies.

As an example this reinsurance we are looking at here represents a difference between the monies owed to this group by Lloyds Reinsurance and goes out on a contra account to Lloyds.

Commercially, I don't think anyone is going to regard Lloyds as a doubtful debt. . Therefore, in terms of a commercial balance sheet or the presentation of a balance sheet it is under reserve as required; but under the Act, due to some past history or regulations, all insurance which is not registered at Ottawa -- Reinsurance not registered at Ottawa is unlicensed; and if you reinsure with an unlicensed reinsurer, you must set up a reserve in the Blue Book for the full amount of these debts on your contra account.

COMMISSIONER GRANT: You are permitted to do it but you must set up a reserve if you do.

MR. SMITH: Well, there is no stipulation in the reserve. These reserves to a large extent, I think, are, shall we say, stipulations by the Department to be sure that insurance companies maintain sufficient assets to meet catrosphe, about which we have talked elsewhere in the brief.

THE CHAIRMAN: Are you properly using the word "reserve" in this connection.

MR. SMITH: No.

THE CHAIRMAN: Reserves indicate that you must establish something in your accounts, I think. I don't think that is indicated by these requirements, is it?

MR. SMITH: It is stipulated by the Blue Book, but that is all.

There is a peculiar situation. The Act which governs the statements in the Blue Book does not refer to an auditor at all.

THE CHAIRMAN: Does not refer to what?

MR. SMITH: Does not refer to an auditor; does not require it to be signed by an auditor in the case of a Federal company.

MR. MICHENER: The three items in the column to which you have referred, Mr. Chairman, and the next one and the one immediately below it are the three reserves, as we call them, on page 19, in inverse order.

COMMISSIONER BEAUVAIS: You show the variations throughout the year.

MR. MICHENER: Yes.

THE CHAIRMAN: So long as business increases, the reserve would go up but when it declines the reserve would go down.

MR. MICHENER: Yes. When business increases in the long run the Treasury loses no taxes. It is tax deferrment.

COMMISSIONER PERRY: Do you know the reason for the 15 per cent requirement? Is it to protect the company against a decline in the value of its assets

or because of a catasrophe?

MR. MICHENER: I think it is additional protection for the policyholder over and above. There is no real measure of the liability of the company. If you take the premiums as the measure of liability, it is obviously not a measure of liability so if you add 15 per cent, it doesn't make much difference. It is arbitrary anyway.

COMMISSIONER PERRY: I am just wondering to what extent there was double counting in this reserve that you are suggesting.

MR. MICHENER: Whether there was a duplication?

COMMISSIONER PERRY: Yes. One could argue that this 15 per cent would serve the purpose of meeting a catastrophic claim but if your resources were always in balance,there would be no need for a reserve.

MR. MICHENER: I think the answer is that there is no measure of your liability. However, unearned premium has been taken as a measurement and that is arbitrary.

We suggest, of course, that all of the earnings of the company should be capable of being treated as a reserve and until they are appropriated to the shareholders' use, we set up this substantial reserve in a continued way.

COMMISSIONER PERRY: To accomplish that result.

MR. MICHENER: Yes, but it might still leave some of them, depending on the experience in the industry.

THE CHAIRMAN: I think you have made your point very clearly indeed, Mr. Michener. I can well understand that and I am sure with sympathy.

Being an accountant, I am perhaps a little petty in my resistance to adapting from what I think is appropriately measured as income. Perhaps there is a wider purpose for reserves than just a measurement of income.

However, we are dealing with income tax which of course, should be related to income. There are many instances where there are concessions allowed by means of a deduction from that income such as special depreciation or reserves for industry of different kinds. Maybe this is a case where irrespective of what accounting measurement is used, some consideration should be given to some special treatment.

I can assure you we will give it our full attention and consideration. Thank you very much indeed for this submission and appearing today and answering our questions very patiently and very fully.

It is nice to have seen you.

MR. MICHENER: We are grateful to have had such a thorough hearing. Thank you very much.

THE SECRETARY: Mr. Chairman, I have not had an opportunity until now to enter into the record as Exhibit 286 the notes which Mr. Michener wished to place on the record as an exhibit. Those were the notes of the ~~T/x~~ Dominion Superintendent of Insurance from his report of 1962;and also Exhibit 287, a pamphlet called "The Law and the Profits" from a speech by

Mr. MacGregor, the Superintendent of Insurance.

THE CHAIRMAN: We will stand over until 9:30 a.m., Thursday morning.

---Adjournment.